EDITOR'S NOTE

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No. 86-751-CFX
Status: GRANTED

Title: Arkansas Best Corporation, Petitioner
v.
Commissioner of Internal Revenue

Docketed:
November 7, 1986

Court: United States Court of Appeals
for the Eighth Circuit

Counsel for petitioner: Hughes Jr.,Vester T., Smidt II,Thomas

Counsel for respondent: Solicitor General

Entry	Date	Note	Proceedings and Orders
1	Nov 7 1986	G	Petition for writ of certiorari filed.
2	Nov 10 1986		Letter from petitioner in compliance with Rule 28.1 filed.
4	Dec 5 1986		Order extending time to file response to petition until January 10, 1987.
6	Jan 7 1987		Order extending time to file response to petition until February 9, 1987.
7	Feb 10 1987		Order further extending time to file response to petition until February 19, 1987.
8	Feb 19 1987		Brief of respondent CIR filed.
9	Feb 25 1987		DISTRIBUTED. March 20, 1987
10	Mar 23 1987		Petition GRANTED.
			**********
11	May 6 1987		Brief amicus curiae of Natl. Council of Farmer Cooperatives filed.
12	May 6 1987		Brief amicus curiae of Kraft, Inc. filed.
13	May 6 1987		Brief of petitioner AR Best Corp. filed.
14	May 6 1987		Joint appendix filed.
17	May 7 1987		Brief amicus curiae of Circle K Corporation filed.
15	May 8 1987		Record filed.
16	May 8 1987		Certified copy of C. A. proceedings received.
18	May 21 1987		Record filed.
20	Jun 8 1987		Order extending time to file brief of respondent on the merits until July 8, 1987.
21	Jul 9 1987		Order further extending time to file brief of respondent on the merits until July 22, 1987.
22	Jul 23 1987		Order further extending time to file brief of respondent on the merits until July 29, 1987.
24	Jul 30 1987		Brief of respondent CIR filed.
25	Aug 6 1987		CIRCULATED.
26	Oct 9 1987		SET FOR ARGUMENT. Wednesday, December 9, 1987. (2nd case).
27	Nov 18 1987	X	Reply brief of petitioner AR Best Corp. filed.
28	Dec 9 1987		ARGUED.

86-751

Supreme Court, U.S.
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CLERK

No._____

The Supreme Court of the United States of America

OCTOBER TERM, 1986

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Court of Appeals for the Eighth Circuit err in holding that losses incurred on sales of corporate stock acquired and held exclusively for business purposes, rather than for investment purposes, did not constitute ordinary business losses under the Internal Revenue Code?

2. Did the Court of Appeals for the Eighth Circuit err in holding that, under Internal Revenue Code §1221, corporate stock not held by a dealer can never qualify as a noncapital asset, regardless of the factual circumstances surrounding its acquisition and retention?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the Court of Appeals for the Eighth Circuit below, reversing the judgment of the Tax Court, is reported at 800 F.2d 215 (8th Cir. 1986). The opinion of the Tax Court is reported at 83 T.C. 640 (1984). The opinions of the Court of Appeals and the Tax Court are reproduced in Appendices A and B hereto, respectively.

STATEMENT OF JURISDICTION

The judgment of the United States Court of Appeals for the Eighth Circuit in this case was entered on September 9, 1986. No rehearing has been sought or ordered, and no request for an extension of time within which to file this petition for certiorari has been made. This Court has jurisdiction to review the judgment of the United States Court of Appeals for the Eighth Circuit under 28 U.S.C. §1254(1).

STATUTORY PROVISION INVOLVED

26 U.S.C. (hereafter "I.R.C.") §1221:

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include —

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for the sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by —

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hand the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by —

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).[1]

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[1] This statutory language reflects the current version of I.R.C. §1221. This section has been amended three times since this Court's decision in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955), as follows:

The Tax Reform Act, Pub. L. No. 91-172, §514(a), 83 Stat. 487, 643 (1969), amended I.R.C. §1221(3) to read as above. The amendment was applicable to sales and other dispositions occurring after July 25, 1969. Prior to amendment, I.R.C. §1221(3) read as follows:

(3) a copyright, a literary, musical, or artistic composition, or similar property, held by —

(A) a taxpayer whose personal efforts created such property, or

(B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property.

The Tax Reform Act of 1976, Pub. L. No. 94-455, §2132(a), 90 Stat. 1520, 1925 (1976), amended I.R.C. §1221 by adding paragraph (6) (what is now paragraph (5)), applicable to sales, exchanges, and contributions made after October 4, 1976. The same Act, at §1901(c)(9), amended I.R.C. §1221(5) by striking out "or Territory," following the word "State", with respect to taxable years beginning after December 31, 1976.

The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §505(a), 95 Stat. 172, 331 (1981), repealed former I.R.C. §1221(5) and redesignated I.R.C. §1221(6) as I.R.C. §1221(5), applicable to property acquired or positions established after June 23, 1981, in the years ending after that date. Prior to amendment, former I.R.C. §1221(5) read as follows:

STATEMENT OF THE CASE

Arkansas Best Corporation (hereafter "Arkansas Best") is a diversified holding company based in Fort Smith, Arkansas. In 1968, it owned subsidiaries engaged in trucking, furniture manufacturing, data processing, and other businesses. Because its earnings from these operations were highly cyclical, Arkansas Best decided to acquire businesses which could provide a more stable pattern of earnings over time. One industry which Arkansas Best identified as having this characteristic was the banking or financial services industry.

In pursuit of this business objective, Arkansas Best in 1968 purchased sixty-five percent of the stock of National Bank of Commerce (hereafter the "Bank"), the fourth largest bank in Dallas, Texas. In 1970, however, new Congressional legislation effectively frustrated Arkansas Best's purpose. The Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, Title I, §103, 84 Stat. 1760 (1970) (hereafter the "Amendments") prohibited a "one-bank" bank holding company from acquiring new businesses unrelated to banking. Thus, the Amendments would effectively prohibit Arkansas Best — as a "one-bank" bank holding company — from expanding its nonbank businesses, such as trucking or furniture manufacturing, through acquisitions.

The Amendments permitted a company which was unwilling to live with such restrictions to avoid them by committing to divest itself of its interest in its bank. Such a company was required to file with the Board of Governors of the Federal Reserve System an irrevocable notice of intention to divest itself of its bank stock. Arkansas Best filed such a notice on August 1, 1971, and promptly commenced efforts to sell its stock in the Bank.

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(5) an obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue; or

Public awareness of Arkansas Best's need to sell its Bank stock made it difficult for Arkansas Best to dispose of that stock. Its efforts were made more difficult by increasingly serious financial problems at the Bank. Beginning in 1971, the Office of the Regional Administrator of National Banks made a series of determinations that the Bank's capital was inadequate and demanded that additional capital be raised. Despite the fact that on August 1, 1971 the board of directors of Arkansas Best had passed a resolution stating that the company would purchase additional Bank stock only when absolutely necessary, the deterioration of the financial condition of the Bank forced Arkansas Best to make just such stock purchases to provide the additional capital demanded by the regulatory authorities.

After it filed its notice of intention to divest itself of its Bank stock on August 1, 1971, Arkansas Best made a number of additional purchases of Bank stock ("post-1971 acquisitions"). It did so in an effort to prevent the imposition of sanctions — including a possible closing of the Bank — by the regulatory authorities. Such sanctions would have severely damaged Arkansas Best's reputation as a responsible, competently managed, diversified holding company, as well as its banking and financial relationships.

As to all of these post-1971 acquisitions of Bank stock, Arkansas Best suffered undisputed losses when it finally was able to sell its interest in the Bank beginning in 1975. Arkansas Best sought to deduct these losses from its income as ordinary losses. The Commissioner of Internal Revenue disallowed such deductions, characterizing them as capital losses. Such capital losses are not deductible against the ordinary income of a corporation, but may be used only to offset capital gains.

Arkansas Best challenged the Commissioner's deficiency determination in the United States Tax Court, which had jurisdiction over the action under I.R.C. §6213. After a full trial, the Tax Court made findings of fact regarding Arkansas Best's purposes in making its post-1971 acquisitions of Bank stock. With respect to the stock acquired by Arkansas Best in 1972, the Tax Court found

that such purchases "were motivated primarily by investment purposes and only incidentally by some business purpose." 83 T.C. at 654, Appendix B at B-18. Based upon this Court's decision in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955), and its own decision in *W. W. Windle Co. v. Commissioner,* 65 T.C. 694 (1976), *appeal dismissed,* 550 F.2d 43 (1st Cir.), *cert. denied,* 431 U.S. 966 (1977), the Tax Court held that Arkansas Best's losses on the sale of such stock were capital losses. 83 T.C. at 655, Appendix B at B-19.

As to Bank stock acquired after 1972, the Tax Court found that "[t]hese later purchases were made exclusively for business purposes and subsequently held for the same reasons." 83 T.C. at 656, Appendix B at B-20. In particular, the Court held:

> Expenditures to preserve business reputation are typically currently deductible business expenses. (citation omitted). The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products.*
>
> . . . .
>
> [Arkansas Best] carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

83 T.C. at 656-57, Appendix B at B-20-21.

Arkansas Best appealed from the Tax Court's finding as to the purpose of the 1972 purchases of Bank stock. Arkansas Best argued that these purchases, like those after 1972, were motivated by business purposes, and not by investment purposes. Among other things, Arkansas Best pointed out the undisputed evidence that it irrevocably had committed itself to sell all of its Bank stock in 1971, and was engaged actively in efforts to accomplish such a divestiture throughout 1972. Its purchases of stock in response to capital calls in 1972 therefore were not part of any effort to invest

in such stock in order to realize a profit, but were made to protect its business reputation and maintain the solvency of the Bank.

The Commissioner, however, appealed from the Tax Court's holding that the losses generated by sales of Bank stock purchased after 1972 were ordinary losses. The Commissioner did not directly challenge the Tax Court's factual findings that the post-1972 stock purchases were made solely for business purposes and with no investment purpose whatsoever. He argued instead that "[t]he findings of fact of the Tax Court demonstrate that the [Bank] stock was never integral to the 'complementary group' of businesses carried on by the taxpayer and its subsidiaries." Brief for the Appellant at 12. The Commissioner contended that the losses resulting from purchases of Bank stock could be treated as ordinary losses only if such stock was "integral" to the business of Arkansas Best.

The Eighth Circuit Court of Appeals on September 9, 1986 held that *all* of the losses resulting from sales of the Bank stock were capital losses. Speaking for a divided court, Judge Bowman held that stock always is a capital asset, regardless of the motives for its acquisition or retention, or any surrounding factual circumstances. The court's opinion expressly rejected holdings of the Courts of Appeals for the Fourth and Fifth Circuits, the Tax Court, and the Court of Claims that had applied this Court's decision in *Corn Products* to stock,[2] and by implication rejected similar holdings of the Courts of Appeals for the Sixth Circuit and Seventh Circuit.[3] In criticizing these decisions, the Eighth Circuit's opinion referred to "*Corn Products* and its progeny,

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[2] *Wright v. Commissioner*, 756 F.2d 1039 (4th Cir. 1985); *Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984); *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed*, 550 F.2d 43 (1st Cir.), *cert., denied*, 431 U.S. 966 (1977); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962).

[3] *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970); *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964).

which we respectfully view as misbegotten." 800 F.2d at 221, Appendix A at A-10.

REASONS FOR ALLOWING THE WRIT

This case involves a rare confluence of several factors which make review of a decision of a court of appeals by this Court necessary. First, the opinion and judgment of the Court of Appeals for the Eighth Circuit in this case is in direct conflict with (and explicitly rejects) the decisions of at least two other courts of appeals, as well as decisions of the Tax Court and the Court of Claims, on the same matter. Second, the Eighth Circuit's opinion and judgment cannot be reconciled with this Court's holding in *Corn Products*, a decision that has been a landmark in United States tax law for over thirty years. Finally, this case squarely presents legal issues which are of fundamental and continuing importance to the proper administration of the tax laws and to the planning of business transactions throughout the nation. Only a definitive decision by the Court in this case can resolve the uncertainty created by the unprecedented ruling of the Eighth Circuit Court of Appeals.

I. THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS DIRECTLY CONFLICTS WITH THE DECISIONS OF OTHER COURTS OF APPEALS, THE TAX COURT, AND THE COURT OF CLAIMS.

The Internal Revenue Code defines as a "capital asset" all property owned by a taxpayer, other than certain enumerated categories of property such as "stock in trade," copyrights, and accounts receivable. I.R.C. §1221. Losses resulting from dispositions of such capital assets generally are available only to offset capital gains and not to offset other income of the taxpayer. In contrast, losses from dispositions of "ordinary" assets generally may be used to reduce ordinary income. I.R.C. §§1211, 1212. On the other hand, certain gains resulting from dispositions of capital assets (long term capital gains) have been taxed at a preferential

rate which is lower than the rate applicable to gains from dispositions of ordinary assets. Therefore, significantly different tax consequences follow from the characterization of a transaction as either capital or ordinary.[4]

In *Corn Products*, the taxpayer had reaped a gain from the purchase and sale of corn futures. The Commissioner opposed the taxpayer's claim that the corn futures were a capital asset and that his profit therefore should be taxed at the preferential capital gains rates. The corn futures — which were used to ensure a supply of corn for the taxpayer's business — clearly did not fall within the literal terms of the exceptions to I.R.C. §1221's definition of "capital asset." The Commissioner nevertheless argued that the futures constituted ordinary assets in view of the specific facts and circumstances of the taxpayer's business.

This Court accepted the Commissioner's argument, holding that I.R.C. § 1221 is not to be read literally. In an opinion for a unanimous Court, Justice Clark wrote:

> Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in [the predecessor of §1221] . . . But the capital asset provision of [the predecessor of §1221] must not be so broadly applied as to defeat rather than further the purpose of Congress.

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[4] The Tax Reform Act of 1986, Pub. L. No. 99-514 (1986) (hereafter the "Tax Reform Act of 1986"), signed by the President on October 22, 1986, does not diminish the great importance of this issue to taxpayers and to the Treasury in cases such as these. Although the Act will eliminate — at least for now — the preferential tax rate applicable to long term capital gains, capital losses generally will continue to be deductible only against capital gains. Thus, as under current law, capital losses in excess of capital gains generally will not be deductible against ordinary income, while ordinary losses will be fully deductible against ordinary income. The new tax provisions thus would not have changed the need for resolution of this case or any of the other cited cases from the Courts of Appeals for the Fourth, Fifth, Sixth and Seventh Circuits, the Tax Court or the Court of Claims.

350 U.S. at 51-52, 76 S.Ct. at 24. The Court stated that "since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly." 350 U.S. at 52, 76 S.Ct. at 24. Thus, the Court held that gains and losses resulting from transactions "vitally important to the taxpayer's business" are not to be taxed as capital transactions. 350 U.S. at 50, 76 S.Ct. at 23.

This Court's holding in *Corn Products* that the particular facts and circumstances of a taxpayer's business in relation to the transaction in question must be considered before the gain or loss with respect to a given asset can be classified as ordinary or capital has been applied by a number of courts in a wide variety of situations over the last thirty years. While certain of these cases, like *Corn Products* itself, involved stock or other intangible assets acquired to guarantee or protect a source of supply,[5] other cases have made it clear that the *Corn Products* doctrine stands for the broader proposition that ordinary gain or loss treatment can apply to a wide range of business-motivated purchases. For example, the *Corn Products* doctrine has been applied where stock or securities were acquired to assure continued business or employment relationships with the issuer of the stock,[6] obtain the use of a valuable asset or the expertise of personnel of the issuing

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[5] *See, e.g., Tulane Hardwood Lumber Co. v. Commissioner*, 24 T.C. 1146 (1955), *acq.*, 1958-1 C.B. 6 (plywood); *Mansfield Journal Company v. Commissioner*, 274 F.2d 284 (6th Cir. 1960) (newsprint); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962) (newsprint); *F. S. Services, Inc. v. United States*, 413 F.2d 548 (Ct. Cl. 1969) (petroleum products).

[6] *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to protect taxpayer's position as general counsel); *Southeastern Aviation Underwriters, Inc. v. Commissioner*, 25 T.C.M. (CCH) 412 (1966) (stock acquired to obtain a contract); *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to preserve an exclusive sales agency).

corporation,[7] reduce import taxes and assembly costs,[8] and meet contract surety and bonding requirements.[9]

Thus, in applying *Corn Products*, courts have analyzed the reasons for the stock acquisition in the context of the taxpayer's business. Where the stock was acquired and held for business motives, rather than to provide an investment return, the stock has been treated as an ordinary business asset. *Datamation Services v. Commissioner*, 35 T.C.M. (CCH) 1092, 1101 (1976). During the development of this case law over the past thirty years, Congress has amended I.R.C. §1221 three times,[10] without once suggesting that the conclusions of these courts that there can be noncapital assets outside the literal language of I.R.C. §1221 are either "misbegotten" or contrary to Congress' intent.[11]

The Eighth Circuit Court of Appeals plainly was aware of the large body of law interpreting the *Corn Products* decision:

> We acknowledge that in post-*Corn Products* decisions some federal courts have taken the position that capital stock is not a

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[7] *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964) (stock in a corporation acquired to obtain a lease held by the corporation); *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971) (stock acquired to obtain the services of a highly skilled team of scientists).

[8] *Pittsburgh Reflector Co. v. Commissioner*, 27 T.C.M. (CCH) 377 (1968).

[9] *Commissioner v. Bagley & Sewall Co.*, 221 F.2d 944 (2d Cir. 1955).

[10] *See* footnote 1, *supra*.

[11] This Court has noted that Congress implicitly validates longstanding and published judicial and administrative interpretations of tax legislation when it reenacts that legislation without substantial change. *See, e.g., Helvering v. Winmill*, 305 U.S. 79, 83, 59 S.Ct. 45, 46, 83 L.Ed. 52 (1938); *Corn Products*, 350 U.S. at 53, 76 S.Ct. at 25 ("Congress has made no change in it [judicial interpretation of tax treatment of hedging transactions] though the Code has been re-enacted on three subsequent occasions. This bespeaks congressional approval.").

capital asset when acquired to assure a supply of raw materials vital to the taxpayer's business, to preserve an existing business, or even to pursue new business. Note, *The Corn Products Doctrine and Its Application to Partnership Interests*, 79 Colum. L. Rev. 341, 343 (1979); Troxell & Noall, *Judicial Erosion of the Concept of Securities as Capital Assets*, 19 Tax L. Rev. 185, 196-207 (1964). A test that some courts apply is the business purpose-investment purpose test: capital stock acquired for business purposes is classified as an ordinary asset, and capital stock acquired for investment purposes is classified as a capital asset. *See Booth Newspapers v. United States*, 303 F.2d 916, 921 (Ct. Cl. 1962); *Dearborn Co. v. United States*, 444 F.2d 1145, 1166 (Ct. Cl. 1971). Other courts have rejected this test, at least for situations in which the taxpayer had mixed motives for acquiring the asset, and have replaced it with a substantial investment purpose test. Note, *supra*, at 347. *See, e.g., W. W. Windle Co. v. Commissioner*, 65 T.C. 694, 703-04 (1976), *appeal dismissed*, 550 F.2d 43 (1st Cir. 1977), *cert. denied*, 431 U.S. 966 (1977); *Wright v. Commissioner*, 756 F.2d 1039, 1041-42 (4th Cir. 1985). Under this test, property is treated as an ordinary asset only if the taxpayer bought and retained it without a substantial investment purpose. Note, *supra*, at 347; *see W. W. Windle*, 65 T.C. at 712, 713, 714 n.15.

800 F.2d at 220, Appendix A at A-8-9. However, the Eighth Circuit then directly and explicitly repudiated all of these cases: "With all due respect to these courts, it is clear to us that both tests lack a basis in the statutory language, and we reject them." 800 F.2d at 220, Appendix A at A-9.

Thus, the decision of the Court of Appeals in this case avowedly conflicts with decisions of the Fourth Circuit Court of Appeals, the Tax Court, and the Court of Claims. In addition, the ruling of the Eighth Circuit necessarily conflicts with other decisions of those courts and of the Second, Fifth, Sixth, and Seventh Circuit Courts of Appeals as cited in notes 5-9, *supra*, all holding that corporate stock or securities could and did constitute an ordinary asset under the facts and circumstances presented in those cases.

Even these cited cases do not exhaust the long list of conflicts between the Eighth Circuit's decision and the decisions of other courts which have applied the *Corn Products* doctrine. Almost simultaneously with the Tax Court's ruling in this case, the Court of Appeals for the Fifth Circuit issued its decision in *Campbell Taggart, Inc. v. United States,* 744 F.2d 442 (5th Cir. 1984).[12] In *Campbell Taggart,* the Fifth Circuit held that a holding company's loss on the disposition of shares of stock gave rise to an ordinary loss in circumstances very similar to those present in the *Arkansas Best* case. The Eighth Circuit acknowledged *Campbell Taggart* as "the case most closely analogous to the one before us," but then stated "[f]or the reasons delineated above, we do not agree with the Fifth Circuit's interpretation of Section 1221." 800 F.2d at 221, Appendix A at A-10.

A brief examination of *Campbell Taggart* makes apparent the parallels with this case. Campbell Taggart, a holding company owning businesses in the food industry, entered into an agreement to purchase fifty percent of the stock of a Spanish corporation that operated a chain of supermarkets. The agreement gave Campbell Taggart the right to terminate the contract if there was any material adverse change in the financial status of the Spanish corporation before the transaction was closed. 744 F.2d at 444-46.

Just such a change occurred, and Campbell Taggart was no longer legally obligated to carry through with the purchase of the stock. However, after considering the negative impact of a failure to acquire the stock on its business reputation, Campbell Taggart — like Arkansas Best in this case — decided to go ahead with the purchase. Also like Arkansas Best, Campbell Taggart began to look for a buyer for the stock immediately — even before the stock purchase was closed. When Campbell Taggart sold the stock at a loss of over one million dollars, it sought to deduct that amount as an ordinary loss.

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[12] The Fifth Circuit's decision was issued only ten days before that of the Tax Court, and it appears that the Tax Court was not aware of *Campbell Taggart* when it decided this case.

The District Court found that, at the time the stock was actually acquired, Campbell Taggart had no investment motive — only a motive to protect its business reputation. *Campbell Taggart, Inc. v. United States,* 552 F.Supp. 355, 357-59 (N.D. Tex. 1982). The Fifth Circuit affirmed, stating that the test under *Corn Products* is simply "whether the asset was acquired with a business purpose or an investment purpose." 744 F.2d at 457-58. The nature of the factual inquiry necessary under *Corn Products* was carefully explained by the Fifth Circuit:

> The inquiry into taxpayer's purpose requires an objective evaluation of all of the circumstances surrounding the transaction. Relevant factors include (1) taxpayer's statements of its subjective intent at the time of acquisition; (2) taxpayer's statements of its subjective intent at the time of disposition; (3) the needs of the particular business; (4) the length of time the asset was held; (5) the nature of taxpayer's other business and investment activities; and (6) the business and investment advantages that might reasonably be expected to flow from the acquisition or expenditure.

Campbell Taggart, Inc., 744 F.2d at 458 (footnotes omitted).

Under the Eighth Circuit's holding in this case, such an inquiry is not only unnecessary but wholly irrelevant. If the asset is "stock," its sale will result in a capital gain or loss regardless of any facts the taxpayer can possibly present. Thus, the Eighth Circuit's holding has introduced a new, and wildly disparate, interpretation of *Corn Products* to the body of jurisprudence that has evolved over the last thirty years. Only review by this Court can definitively resolve the direct conflict among the courts of appeals, the Tax Court, and the Claims Court which plainly exists in this case. This alone is ample reason for the granting of this petition for writ of certiorari. *See* Rule 17.1(a), Rules of United States Supreme Court.

II. THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS CANNOT BE RECONCILED WITH THIS COURT'S DECISION IN *CORN PRODUCTS*

In its opinion in this case, the Eighth Circuit Court of Appeals emphasized its conclusion that the wording of I.R.C. §1221 requires that the Bank stock be regarded as a capital asset under any and all circumstances. It seemed to view this Court's *Corn Products* decision as an aberration from the proper, "literal" application of the statute. The court stated that "[a]lthough a literal reading of section 1221 clearly requires capital stock to be treated as a capital asset, the decision of the Supreme Court in [*Corn Products*] placed a judicial gloss on the section." 800 F.2d at 219, Appendix A at A-6.

After describing the *Corn Products* decision, the Eighth Circuit then suggested that the continuing vitality of that case was questionable. In its reference to this Court's decision in *United States v. Mississippi Chemical Corporation*, 405 U.S. 298, 92 S.Ct. 908, 31 L.Ed.2d 217 (1972), the opinion stated: "In *Mississippi Chemical*, the Supreme Court based its characterization of capital stock as a capital asset solely on the language of section 1221, and ignored its previous decision in *Corn Products* entirely." 800 F.2d at 219-20, Appendix A at A-8.[13] The Eighth

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[13] This Court did not discuss *Corn Products* in deciding *Mississippi Chemical* because *Corn Products* was irrelevant to the issue before the Court in that case. As the Government recognized in its brief in *Mississippi Chemical*:

> Respondents are not helped by cases purporting to apply the rationale of [*Corn Products*] ..... [T]he issue in [the *Corn Products*-related] cases is whether the stock sold was a *capital* asset within the meaning of Section 1221. (It was assumed in each case that the stock was an asset.) Here, on the other hand, there has been no sale, and the issue is whether the stock purchased is an asset, not whether it is a capital asset.

See Brief for United States at 37 n.33, *United States v. Mississippi Chemical Corporation*, 405 U.S. 298, 92 S.Ct. 908, 31 L.Ed.2d 217

Circuit based its decision in this case on principles unmistakably inconsistent with the holding of this Court in *Corn Products*:

> *Corn Products* and its progeny, which we respectfully view as misbegotten, have [led] to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' motivations in purchasing capital stock. . . . We believe that the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make.

800 F.2d at 221, Appendix A at A-10.

The inconsistency of the Eighth Circuit's opinion in this case with this Court's decision in *Corn Products* is made clear by this example. Suppose that Corn Products Refining Company, instead of purchasing corn futures to ensure its supply of corn, had chosen to purchase all of the stock of a grain dealer for the same purpose. In years in which the Refining Company needed no additional supply, the grain dealer would sell its grain to customers on the open market. In other years, however, the grain dealer could supply the business needs of the Refining Company for corn at a reasonable price — precisely the function performed by corn futures.

Under the Eighth Circuit's decision in this case, a gain or loss on the sale of such stock plainly would be a capital gain or loss. "Stock" is a capital asset under that decision regardless of any other circumstances. Under the rationale of *Corn Products*, however, any gain or loss on such stock can only be an ordinary gain or loss. Thus, despite the Eighth Circuit's silence on this precise point, it is unavoidable that the Eighth Circuit's decision in this

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(1972) (No. 71-52). The Eighth Circuit apparently believed that *Mississippi Chemical* overruled *Corn Products sub silentio*. The Eighth Circuit misread *Mississippi Chemical* by confusing the issue of *when* gains and losses are *recognized* with the issue of the *characterization* of those gains and losses, once recognized, as capital or ordinary.

case and *Corn Products* are in conflict. The decisions in the two cases simply cannot be reconciled, and only this Court can determine which one correctly states the law on this important issue.

Arkansas Best believes that *Corn Products* was correctly decided, and that the rigid approach to statutory interpretation followed by the Eighth Circuit is inappropriate. A willingness to interpret the tax law so as to carry out the *purposes* of Congress, rather than the letter of the statute only, has been a central feature of this Court's decisions both before and after *Corn Products*. *See Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462, 53 S.Ct. 257, 77 L.Ed. 428 (1933) (imposition of nonstatutory requirement of "continuity of proprietary interest" to qualify as a tax-free reorganization); *Helvering v. Morgan's Inc.*, 293 U.S. 121, 126, 55 S. Ct. 60, 61, 79 L.Ed. 232 (1934) ("The true meaning of a single section of a statute in a setting as complex as that of the revenue acts, however precise its language, cannot be ascertained if it be considered apart from related sections, or if the mind be isolated from the history of the income tax legislation of which it is an integral part."); *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935) (literal compliance with statute does not give rise to tax-free reorganization in absence of business purpose); *Hillsboro National Bank v. Commissioner*, 460 U.S. 370, 103 S.Ct. 1134, 75 L.Ed.2d 130 (1983) (corporation must recognize income under tax benefit rule despite express non-recognition treatment provided by I.R.C. § 336(a)); *Commissioner v. Tufts*, 461 U.S. 300, 103 S.Ct. 1826, 75 L.Ed.2d 863 (1983) (amount realized upon disposition equals the full amount of a nonrecourse mortgage in excess of the property's fair market value even though not within the meaning of "amount realized" as defined in I.R.C. § 1001(b)); *Bob Jones University v. United States*, 461 U.S. 574, 103 S.Ct. 2017, 76 L.Ed.2d 157 (1983) (a qualifying "educational" organization under I.R.C. § 501(c)(3) must additionally be charitable in the common law sense in order to qualify for tax exempt status). As stated by Judge Hanson in dissenting from the Eighth Circuit's opinion in this case:

> The majority opinion scorns *Corn Products* and its progeny as fostering uncertainty in taxpayer's motivations in purchasing capital stock, favoring instead a return to the literal meaning of section 1221. . . .
>
> It appears to me, however, that *Corn Products* was merely an attempt to divine Congressional intent.

800 F.2d at 221, Appendix A at A-11. Arkansas Best therefore believes — like every court other than the Eighth Circuit which has considered these issues — that *Corn Products* is neither moribund nor a case to be effectively overruled *sub silentio*.

The attempt by the Eighth Circuit to support its unprecedented decision in this case on the ground that it establishes a bright-line rule which does not require administrative or judicial determination of a taxpayer's motivations also ignores the countless other areas of the tax law which expressly require just such a determination. I.R.C. §1221(1) itself defines as a noncapital asset property "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." This determination by necessity involves considering the taxpayer's motives for holding an asset — for sale to customers or as an investment. While avoiding the need for administrative and judicial proceedings to determine a taxpayer's subjective intentions may be an overriding goal of the Eighth Circuit, it is apparent that Congress in enacting I.R.C. §1221 did not assign such a high priority to that goal.

If Arkansas Best is correct in this respect, the Eighth Circuit's decision in this case clearly should be reversed by this Court. It is the duty of a court of appeals in our judicial system to apply the law as set forth in this Court's decisions, regardless of the views of the court of appeals as to the correctness or wisdom of such decisions. *See, e.g., Hutto v. Davis*, 454 U.S. 370, 374-75, 102 S.Ct. 703, 706, 70 L.Ed.2d 556 (1982); *Jaffree v. Wallace*, 705 F.2d 1526, 1532-33 (5th Cir. 1983); *United States v. Caldwell*, 543 F.2d 1333, 1370 (D.C. Cir. 1975), *cert. denied*, 423 U.S. 1087 (1976). The precedents established by this Court must be followed unless and until they are overruled. *See, eg., Thurston Motor Lines, Inc. v. Jordan K. Rand, Ltd.*, 460 U.S. 533, 535, 103

S.Ct. 1343, 1344, 75 L.Ed.2d 260(1983). Because *Corn Products* simply cannot be reconciled with the Eighth Circuit's assertion that "the judiciary lacks authority to create exceptions" to the literal language of I.R.C. §1221, Arkansas Best believes that certiorari should be granted to resolve that conflict and ensure that this Court's decisions are faithfully applied. *See* Rule 17.1(c), Rules of United States Supreme Court; *see also Vermont Yankee Nuclear Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 525, 98 S.Ct 1197, 1202, 55 L.Ed.2d 460 (1978).

Even if Arkansas Best were wrong in this, however, certiorari would still be called for here. If *Corn Products* is to be effectively overruled, it is this Court and this Court alone which has the authority to take that action. Accordingly, certiorari is essential to the proper functioning of our federal judicial system under the circumstances of this case, regardless of its ultimate outcome.

III. REVIEW OF THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS IS NEEDED TO PROMOTE UNIFORM ADMINISTRATION OF THE TAX LAWS AND PROPER PLANNING FOR BUSINESS TRANSACTIONS.

Prior to the Eighth Circuit's decision in this case, the courts uniformly had held that corporate stock transactions could, in certain circumstances, give rise to ordinary gains or losses. Tax advisers and planners throughout the nation were aware of the "business purpose — investment purpose" dichotomy set forth in the Court of Claims' decision in *Booth Newspapers*, and the "mixed motive" holding of the Tax Court in *W.W. Windle*. Their advice was based on those decisions and other similar ones, and taxpayers have acted on that advice.

With the decision of the court of appeals in this case, the predictability of the tax consequences of stock transactions in various states has been diminished greatly. A taxpayer who anticipates purchasing stock for what he and his advisers believe clearly are business purposes, rather than investment purposes,

may have a very difficult time assessing the possible tax results. If a loss ensues and the taxpayer is in a circuit which has not yet ruled on the issues presented in this case, who is to know whether the loss will be treated as ordinary or capital?

Just as undesirable as the lack of predictability of tax results are the inequities in the administration of the tax laws which would result if the Eighth Circuit's decision were not reviewed by this Court. The same business transaction should not generate vastly different federal tax consequences depending upon whether the taxpayer is based in Arkansas or across the state line in Texas or Louisiana.[14] The tax consequences to the Arkansas taxpayer also should not vary greatly based upon its decision to challenge an assessment of tax by the Commissioner in the Tax Court and Eighth Circuit rather than to seek a refund of the tax paid in the Claims Court under *Booth Newspapers*.

These uncertainties and conflicts among the circuits must be resolved, because they will not simply fade away. The distinction between capital gains and losses and ordinary gains and losses which is at the heart of I.R.C. §1221 will continue to have great significance even under the changes in the tax law to be made by the Tax Reform Act of 1986. These changes will cause long term capital gains and ordinary income to be taxed at the same rates beginning in 1988.[15] However, only ordinary losses (and not capital losses) will be available to offset ordinary income. For example, a taxpayer with capital losses and ordinary income, but

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[14] For example, if the Bank stock at issue in this case had been purchased by a Texas company which was in all other respects identical to Arkansas Best, the Fifth Circuit's decision in *Campbell Taggart* would have compelled a far different result than that reached by the Eighth Circuit.

[15] The Conference Report explicitly states that the provisions relating to capital gains, including the definition of capital asset, are to remain in the Internal Revenue Code in contemplation of a possible restoration of a preferential tax rate for capital gains in the future. H.R. Rep. No. 841, 99th Cong., 2nd Sess. 106 (1986).

no capital gains, will not be able to utilize the capital losses to offset his ordinary income, despite the fact that the ordinary income will be subject to the same maximum rate of tax as capital gains. Similarly, if a taxpayer like that in *Corn Products* realizes a gain on corn futures, its capital losses will not offset that gain. Thus, the capital/ordinary asset distinction will continue to play a vital role under the new tax law, and a clear resolution of the issues presented in this case will be critical both to taxpayers and to the proper administration of the tax laws. *See, e.g., Donaldson v. United States*, 400 U.S. 517, 522, 91 S. Ct. 534, 538, 27 L.Ed.2d 580 (1971).

CONCLUSION

For all of these reasons, certiorari should be granted in this case. The decision of the Eighth Circuit does not merely modify the settled law under *Corn Products*; it effectively repudiates that law and the many decisions of the courts of appeals, the Tax Court, and the Court of Claims interpreting *Corn Products*. The continuing existence of such a decision by the Court of Appeals for the Eighth Circuit in an area of such economic importance cannot fail to have serious adverse results, and a clarification of the law by this Court is the only remedy.

Respectfully submitted,

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APPENDIX

APPENDIX A

United States Court of Appeals
For The Eighth Circuit
800 F.2d 215
No. 85-1702
No. 85-1818

APPENDIX B

United States Tax Court
83 T.C. No. 35
Docket No. 18954-80

APPENDIX A

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 85-1702

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,
Appellee,
v.
COMMISSIONER OF INTERNAL REVENUE,
Appellant.

Appeal from the United States Tax Court

No. 85-1818

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,
Appellant,
v.
COMMISSIONER OF INTERNAL REVENUE,
Appellee.

Appeal from the United States Tax Court

Submitted: February 13, 1986
Filed: September 9, 1986

Before HEANEY and BOWMAN, Circuit Judges, and HANSON,* Senior District Judge.

* The HONORABLE WILLIAM C. HANSON, Senior District Judge for the Southern District of Iowa, sitting by designation.

BOWMAN, Circuit Judge.

The issue in this case is whether a corporate taxpayer is entitled to ordinary loss treatment for losses incurred on transactions in the capital stock of another corporation. Both Arkansas Best Corporation (Arkansas Best) and the Commissioner of Internal Revenue (Commissioner) appeal the Tax Court's judgment upholding in part and disallowing in part the Commissioner's treatment of Arkansas Best's losses on such transactions as capital losses. *Arkansas Best Corp. & Subsidiaries v. Commissioner*, 83 T.C. 640 (1984). Arkansas Best also appeals the court's ruling upholding the Commissioner's disallowance of a claimed bad debt deduction. *Id.* at 660-62. We reverse insofar as the Tax Court allowed ordinary loss treatment for any of the capital stock transactions. In all other respects, we affirm.

I.

Arkansas Best is a diversified holding company. Its subsidiaries are engaged in various endeavors including interstate trucking, new tire sales, used tire retreading, and data processing. In 1968, Arkansas Best acquired approximately 65% of the stock of the National Bank of Commerce (Bank). In 1970, Congress amended the Bank Holding Company Act, Pub. L. No. 91-607, Title 1, § 103, 84 Stat. 1763 (codified at 12 U.S.C. § 1841 *et seq.*), to prohibit bank holding companies such as Arkansas Best from acquiring nonbanking businesses. Thereafter, in August 1971, Arkansas Best filed a notice of divestiture and began trying to sell its Bank stock. Once the notice was filed, Arkansas Best, although still a bank holding company, was free to acquire nonbanking businesses.

Because the Bank had made a series of bad loans, selling the Bank stock proved difficult. While actively trying to sell its interest in the Bank, Arkansas Best participated in preemptive rights offerings and capital calls to improve the Bank's capital structure. In 1972, Arkansas Best also bought the Bank president's personal holdings of Bank stock to secure his resignation

and noninterference in the sale of Arkansas Best's interest in the Bank shares. In addition, in 1974 Arkansas Best bought the Bank stock held by one of its subsidiaries, an insurance company.

In 1975, Arkansas Best finally was able to sell over half of its holdings of Bank stock to a group of Texas investors. It received cash and a nonrecourse note secured by the stock. Shortly thereafter, Arkansas Best's independent auditors recommended that it charge off its books $4,485,876 of the face amount of the note, although the note was not in default, reducing its basis to $1,520,300. Three months later, Arkansas Best sold the note for $1,652,500. It also granted a third party an option to purchase its remaining shares of Bank stock in installments; by the end of 1980, Arkansas Best no longer held any shares of Bank stock. On its 1975 income tax return, Arkansas Best claimed an ordinary loss deduction of $9,995,688 from the disposition of the Bank stock, and on its 1976 income tax return, it claimed a deduction for an ordinary loss of $4,353,656 from the sale of the note. The Commissioner disallowed both deductions, deciding that the losses resulting from the sales of stock were capital losses subject to 26 U.S.C. § 1221. Arkansas Best challenged those disallowances in a petition to the Tax Court. As an alternative in its petition, Arkansas Best claimed it was entitled to a deduction on its 1975 income tax return of $4,485,876 for the partial worthlessness of the note. Before the Tax Court, Arkansas Best dropped the 1976 claim deduction and asserted only the claim for a 1975 deduction for the partial worthlessness (bad debt) of the note.

The Tax Court held that the loss realized on stock acquired from 1968 through 1972 was a capital loss because the Bank was not an integral and necessary part of Arkansas Best's business. The shares were an investment. 83 T.C. at 655. However, the court also held that the purchase of stock from the Bank president in 1972 was motivated by business purposes and that the loss upon sale of that stock was entitled to ordinary loss treatment. *Id.* at 657. Similarly, the court found that Arkansas Best's purchases of Bank stock after 1972 were made to protect its business reputation, and therefore that it was entitled to ordinary loss

treatment for losses realized on the disposition of Bank stock acquired after 1972, except in the case of Bank stock that Arkansas Best acquired from a subsidiary in 1974. *Id.* The court further held that the Commissioner had not abused his discretion in denying the deduction for the partial worthlessness of the note as claimed in Arkansas Best's 1975 income tax return. *Id.* at 661.

On appeal, Arkansas Best challenges three aspects of the Tax Court's decision: (1) that its losses realized on stock acquired in preemptive rights offerings were not entitled to ordinary loss treatment; (2) that it is not entitled to ordinary loss treatment on its losses from the Bank stock purchased from its subsidiary; and (3) that it is not entitled to a bad debt deduction for the 1975 tax year for the losses attributable to the nonrecourse note. The Commissioner appeals the Tax Court's decision that Arkansas Best is entitled to ordinary loss treatment for losses incurred on stock acquired after 1972 and for losses incurred on stock acquired from the Bank president.

II.

Arkansas Best argues that all the purchases of Bank stock it made after declaring it would divest itself of the stock were made in the ordinary course of business. Distinguishing its concededly pre-August 1971 investment motives for buying the Bank stock, Arkansas Best asserts that its subsequent purchases were intended to preserve its business reputation by preventing the Bank from failing, and that losses incurred on the sale of the stock so acquired are ordinary business expenses that it can deduct in full from gross income.

Whether these arguments have merit depends upon whether any of the Bank stock that Arkansas Best acquired can be characterized as not being a "capital asset" within the meaning of 26 U.S.C. § 1221. This section establishes a general rule defining capital asset as "property held by the taxpayer (whether or not connected with his trade or business) . . . ." The corresponding federal regulation, 26 C.F.R. § 1.1221-1(a), states that "[t]he

term 'capital assets' includes all classes of property not specifically excluded by section 1221." The property that section 1221 excludes from the general rule is (1) stock in trade or inventory; (2) business property subject to the depreciation allowance or real property used in business; (3) copyrights, literary or artistic compositions, and similar property; (4) business-related accounts or notes receivable; and (5) federal government publications. Because capital stock plainly does not fall into any of the last four categories, we consider only the first exception, 26 U.S.C. § 1221(1), which excludes from "capital asset"

> stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business . . . .

Generally, capital stock would meet this exception only if the taxpayer's business consisted of dealing in securities. *See Campbell Taggart, Inc. v. United States,* 744 F.2d 442, 449 (5th Cir. 1984); 3A J. Rabkin & M. Johnson, *Federal Income, Gift and Estate Taxation* § 34.01A(1), at 3405a (1986).[1] Arkansas Best is not a dealer in securities. It is a holding company which provides management services to its subsidiaries in exchange for fees. Arkansas Best also realizes income from the dividends it receives on the stock it holds. Arkansas Best did not hold its Bank stock and it never has held its stock in any of its subsidiaries for sale to "customers." Rather, it holds capital stock to secure a controlling interest in each subsidiary and to derive income therefrom.

We conclude that the Bank stock was a capital asset because it does not fall into one of the statutory exceptions. The underlying purpose of section 1221 and its legislative history reinforce our

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[1] If Arkansas Best were characterized as dealing in securities, it would be subject to the capital gains and ordinary loss provisions of 26 U.S.C. § 1236, which singles out security dealers for special treatment, rather than to section 1221.

conclusion. According to H.R. Rep. 704, 73d Cong. 2d Sess. (1934), the purpose of the tax code amendments, part of which defined "capital asset," was to increase revenue by preventing tax avoidance. *Id.* at 1. Elsewhere, the report specifically refers to the definition of capital asset: "It will be noted that the definition includes all property, except as specifically excluded." *Id.* at 31. This language is virtually identical to that of Federal Regulation 1.1221-1(a). *See generally* Troxell & Noall, *Judicial Erosion of the Concept of Securities as Capital Assets,* 19 Tax L. Rev. 185, 186 (1964).

Although a literal reading of section 1221 clearly requires capital stock to be treated as a capital asset, the decision of the Supreme Court in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46 (1955), placed a judicial gloss on the section. In that case, the Court considered the taxpayer's contention that income from trading in corn futures was entitled to capital gains treatment. The Court found that the purchases of corn futures by the taxpayer, which was a manufacturer of products derived from corn, were important to its business because they assured a source of raw material for less than the cost of building additional storage facilities. The Court likened the corn futures contracts to a stored inventory of raw corn, 350 U.S. at 50, and held that under section 117 (identical for our purposes to section 1221) the taxpayer was not entitled to treat the profit made on the corn futures transactions as capital gains; rather, those profits were ordinary income. *See id.* at 51-52.

The Supreme Court recognized in *Corn Products* that the taxpayer's transactions did not fall within the literal language of the exclusions in section 117. The Court reasoned, however, that

> Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than [as] capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. . . . Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition

> of a capital asset must be narrowly applied and its exclusions interpreted broadly.

Id. (citations omitted).

Our Court has declined all previous invitations to extend *Corn Products* beyond its facts. In *Municipal Bond Corp. v. Commissioner,* 382 F.2d 184 (8th Cir. 1967), our Court adhered to the view expressed by the Supreme Court in *Malat v. Riddell,* 383 U.S. 569, 572 (1966), that the purpose of section 1221 is to differentiate between (1) the profit and loss attributable to daily business operations and (2) the change in value of an asset accruing over a substantial time period. Our Court held that there was no substantial evidence to support the Tax Court's finding that the taxpayer's real estate had been acquired primarily for sale in the ordinary course of business. Therefore, we held that the proceeds of the sale of the property were entitled to capital gains treatment. *Municipal Bond,* 382 F.2d at 187. *See Vaaler v. United States,* 454 F.2d 1120, 1122-23 (8th Cir. 1972) (contract for performance of personal services is not a capital asset and lump sum paid to extinguish the right to render such services is ordinary income); *Frank v. Commissioner,* 321 F.2d 143, 148-49 (8th Cir. 1963) (taxpayers were engaged in the business of selling stock; thus the gains realized from stock transactions were not entitled to capital asset treatment). In *Stephens, Inc. v. United States,* 464 F.2d 53, 57-58 (8th Cir. 1972), *cert. denied,* 409 U.S. 1118 (1973), this Court held that " 'investor' status attaches to anyone, including a recognized 'dealer,' who acquires securities with the primary intent to profit from their income yield." The Court concluded that the investment company was not a "dealer" entitled to an ordinary loss deduction for shares of corporate stock purchased with a view to gaining an economic advantage through receipt of dividends and an increase in the market price of the shares.

In *M.F.A. Central Cooperative v. Bookwalter,* 427 F.2d 1341 (8th Cir. 1970), *cert. denied,* 405 U.S. 1045 (1972), this Court anticipated the result of a later Supreme Court decision involving identical facts, *United States v. Mississippi Chemical Corp.,* 405

U.S. 298 (1972). In *Mississippi Chemical*, the Supreme Court based its characterization of capital stock as a capital asset solely on the language of section 1221, and ignored its previous decision in *Corn Products* entirely. Under the Farm Credit Act of 1933, 12 U.S.C. § 1134 *et seq.*, the taxpayers were required to make quarterly purchases of the stock of the regional Bank for Cooperatives (Regional Bank) in amounts tied to their interest payments to the Regional Bank. On their tax returns, the taxpayers claimed interest expense deductions for the stock. The Supreme Court held that since the stock was "of value in more than one taxable year, it is a capital asset within the meaning of § 1221 of the Internal Revenue Code, and its cost is nondeductible." 405 U.S. at 310.

In *M.F.A. Central Cooperative*, the taxpayers similarly were required under the Farm Credit Act of 1933 to invest in capital stock of the Regional Bank in an amount dependent upon the interest they owed on their Regional Bank loans. In deciding the case, this Court, like the Supreme Court later, relied upon the plain language of section 1221 and found that the stock fully met the definition of capital asset and did not satisfy any of the section 1221 exclusions. 427 F.2d at 1343. Our Court therefore held that the stock was a capital asset and that the purchase price could not be considered an ordinary business expense. *Id.* at 1344.

Although *Mississippi Chemical* and *M.F.A. Central Cooperative* deal with the tax treatment of the acquisition cost of capital stock rather than the tax treatment of gains or losses upon the disposition of capital stock, we find no principled basis upon which to distinguish those cases from the present case. We thus hold that Arkansas Best's losses upon disposition of the Bank stock are not entitled to ordinary loss treatment, regardless of when or why the stock was acquired.

We acknowledge that in post-*Corn Products* decisions some federal courts have taken the position that capital stock is not a capital asset when acquired to assure a supply of raw materials vital to the taxpayer's business, to preserve an existing business, or even to pursue new business. Note, *The Corn Products Doctrine*

and Its Application to Partnership Interests, 79 Colum. L. Rev. 341, 343 (1979); Troxell & Noall, *supra,* at 196-207. A test that some courts apply is the business purpose-investment purpose test: capital stock acquired for business purposes is classified as an ordinary asset, and capital stock acquired for investment purposes is classified as a capital asset. *See Booth Newspapers v. United States,* 303 F.2d 916, 921 (Ct. Cl. 1962); *Dearborn Co. v. United States,* 444 F.2d 1145, 1166 (Ct. Cl. 1971). Other courts have rejected this test, at least for situations in which the taxpayer had mixed motives for acquiring the asset, and have replaced it with a substantial investment purpose test. Note, *supra,* at 347. *See, e.g., W. W. Windle Co. v. Commissioner,* 65 T.C. 694, 703-04 (1976), *appeal dismissed,* 550 F.2d 43 (1st Cir. 1977), *cert. denied,* 431 U.S. 966 (1977); *Wright v. Commissioner,* 756 F.2d 1039, 1041-42 (4th Cir. 1985). Under this test, property is treated as an ordinary asset only if the taxpayer bought and retained it without a substantial investment purpose. Note, *supra,* at 347; *see W. W. Windle,* 65 T.C. at 712, 713, 714 n.15. With all due respect to these courts, it is clear to us that both tests lack a basis in the statutory language, and we reject them.

The case most closely analogous to the one before us is the Fifth Circuit's decision in *Campbell Taggart,* 744 F.2d at 442. There, a holding company that derived its income from service fees and dividends from its subsidiaries negotiated the purchase of the capital stock of a supermarket chain in Spain. Before the purchase was consummated, Campbell Taggart discovered problems in the chain's financial condition and decided to sell the 25% interest it previously had acquired during the negotiations. It nevertheless proceeded with the final purchase agreement and purchased an additional 25% interest as the parties originally had contemplated. Selling the stock at a substantial loss thereafter, it claimed an ordinary deduction for the loss incurred. Campbell Taggart argued that it consummated the final purchase only to protect its good will and reputation, and that "because it lacked an investment motive . . . the stock, which all agree is normally a capital asset, was an ordinary asset under the *Corn Products* doctrine." *Id.* at 446 (footnote omitted). The Fifth Circuit

concluded that stock is entitled to ordinary asset treatment when there is no investment purpose and it was acquired as an indirect means of incurring otherwise deductible business expenses. *Id.* at 451. The court held that "the *Corn Products* doctrine is triggered by a finding of business purpose, as opposed to investment purpose, in acquiring what would otherwise be a capital asset." *Id.* at 458.

For the reasons delineated above, we do not agree with the Fifth Circuit's interpretation of section 1221. We do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221. It seems to us that one of the last places where the legal system deliberately should foster subjectivity and uncertainty is in the tax code. *Corn Products* and its progeny, which we respectfully view as misbegotten, have done precisely that, leading to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' motivations in purchasing capital stock. Congress could have written section 1221 to incorporate some sort of exception regarding capital stock, just as it recognized the unique position of securities dealers in 26 U.S.C. § 1236, but it did not do so. We believe that the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make.

III.

The final issue is whether the Tax Court properly ruled that Arkansas Best was not entitled to a partial bad debt deduction for 1975 based on its write-down of the nonrecourse note it received as partial consideration for its sale of Bank stock to the Texas investors. "The question whether a taxpayer may take a partial bad debt deduction is . . . committed to the sound discretion of the Commissioner, and his judgment is controlling unless it is plainly arbitrary or unreasonable." *Wilson Brothers & Co. v. Commissioner,* 124 F.2d 606, 609 (9th Cir. 1941). The burden is on the taxpayer to prove the worthlessness of the debt in the year claimed. *Record Wide Distributors v. Commissioner,* 682 F.2d

204, 207 (8th Cir. 1982), *cert. denied,* 459 U.S. 1171 (1983). Our review of the Tax Court proceeding is limited to determining whether substantial evidence exists to support the court's decision. *Riss v. Commissioner,* 478 F.2d 1160, 1164 (8th Cir. 1973). We conclude that there is substantial evidence to support the Tax Court's ruling that the Commissioner did not abuse his discretion in disallowing this deduction.

IV.

For the reasons stated above, we reverse the judgment of the Tax Court to the extent that it grants Arkansas Best ordinary loss treatment for the losses it incurred on Bank stock purchased after 1972 and on Bank stock purchased from the Bank president in 1972. In all other respects, the judgment of the Tax Court is affirmed.

HANSON, Senior District Judge, dissenting.

I must dissent to section II of the Court's opinion. The majority opinion scorns *Corn Products* and its progeny as fostering uncertainty in taxpayers' motivations in purchasing capital stock, favoring instead a return to the literal meaning of section 1221. The majority therefore falls in line with those critical of all *Corn Products* has wrought.

It appears to me, however, that *Corn Products* was merely an attempt to divine congressional intent. As such, it is a compelling rejoinder to those who believe "that legislative draftsmen and the tax-writing committees of the Congress are the most desirable forum for illuminating a subject matter they themselves made obscure and interminable." Javaras, "Corporate Capital Gains and Losses — The *Corn Products* Doctrine, 52 Taxes 770, 794 (1974).

After it announced in 1971 that it would divest its Bank holdings, Arkansas Best was compelled to infuse capital into the Bank in order to preserve its equity in the Bank. It is therefore apparent that, consistent with *Corn Products,* the stock was

purchased as an integral and necessary act in the conduct of Arkansas Best's business as a holding company. *See Booth Newspapers, Inc. v. United States*, 303 F.2d 916, 921 (Ct. Cl. 1962).

Nor am I convinced that this Circuit has in the past narrowly construed *Corn Products. Municipal Bond Corp. v. Commissioner*, 341 F.2d 683 (8th Cir. 1965), specifically did not narrow *Corn Products*, but rather dealt only with the plain meaning of the unambiguous word "primarily." *Id.* at 668. In addition, *M.F.A. Central Cooperative v. Bookwalter*, 427 F.2d 1341 (8th Cir. 1970), *cert. denied*, 405 U.S. 1045 (1972), cannot support the majority's conclusion that this Circuit follows the plain meaning of section 1221 in all cases. Indeed, the focus in *M.F.A. Cooperative* had to do with stock which at no point could be said to have been worthless; rather, the Court found dispositive the fact that the stock had substantial value. *Id.* at 1343-44. There can be no doubt that in this case purchases after 1972 were at a substantial loss, and were an attempt to avoid liquidation of the Bank and to preserve the insurance license of its subsidiary, Universal.

I therefore would hold that Arkansas Best was entitled to ordinary loss treatment on its purchase of stock after 1972.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS, EIGHTH CIRCUIT.

83 T. C. No. 35
United States Tax Court

ARKANSAS BEST CORPORATION and SUBSIDIARIES, *Petitioner v.* COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Docket No. 18954-80. Filed October 29, 1984.

In 1968, petitioner ABC, a diversified holding company, acquired approximately 65 percent of the stock of NBC, a bank. The transaction was intended by ABC and accepted by the Internal Revenue Service as a tax-free corporate reorganization under sec. 368(a)(1)(C), I.R.C. 1954. ABC acquired additional shares of NBC stock during the period 1969-1976 by purchase, capital calls and stock dividends.

Legislation enacted by Congress subsequent to 1968 regulating bank holding companies effectively required ABC to divest itself of the NBC stock. ABC sold 51 percent of NBC's stock in 1975 for cash and a note secured by the stock. ABC disposed of its remaining interest in NBC over the following five years.

Held, the acquisition of NBC stock by ABC during the period 1968-1972 was motivated primarily by investment purpose and consequently ABC realized a capital loss upon disposition of the stock. *Held further*, ABC's acquisition and retention of NBC stock during the years 1973-1976 was exclusively for business purposes and thus ABC incurred an ordinary loss from the sale of NBC stock acquired during this later period. *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), appeal dismissed 550 F.2d 43 (1st Cir. 1977), followed.

Held further, ABC is barred from asserting under the doctrine of "duty of consistency" that its acquisition of 65 percent of the stock of NBC in 1968 was not a tax-free reorganization under sec. 368(a)(1)(C), I.R.C. 1954. *Bartel v. Commissioner*, 54 T.C. 25 (1970), followed.

Held further, ABC is not entitled to deduct as a partially worthless debt its charge off of a portion of the note received from the sale of NBC stock.

Vester T. Hughes, Jr., David F. P. O'Connor, Eric R. Cromartie, and *Stephen D. Good,* for the petitioner.

Raymond L. Collins, and *Rebecca W. Wolfe,* for the respondent.

NIMS, *Judge:* Respondent determined deficiencies in petitioner's Federal income tax as follows:

Year	Deficiency
1969	$ 20,224
1970	20,224
1971	50,560
1972	3,355,968
1973	244,352
1974	230,519
1975	928,911
1976	2,077,163

After concessions, the issues presented for decision are (1) whether petitioner's loss on the sale of its controlling interest in a bank is ordinary or capital loss, (2) whether the bank stock was acquired in a transaction qualifying as a tax-free reorganization under section 368(a)(1)(C),[1] and (3) whether petitioner is entitled to a bad debt deduction for the partial charge-off of a note acquired in connection with the sale of the bank stock.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly.

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[1] All section references are to the Internal Revenue Code of 1954, as in effect for the years in issue, unless otherwise indicated. All rule references are to the Tax Court Rules of Practice and Procedure, except as noted.

Petitioner had its principal office in Fort Smith, Arkansas, at the time the petition in this case was filed.

Arkansas Best Freight System, Inc. (ABF) is a successful trucking line operating in the midwestern United States. During its early existence, ABF grew primarily by acquiring established trucking companies. In the early 1960's, ABF's banker, First National City Bank (now "Citibank"), suggested that a holding company be formed to facilitate acquisitions and avoid various restrictions which accompanied the truckline's regulation by the Interstate Commerce Commission (ICC).

In March, 1966, Arkansas Best Corporation (hereinafter Arkansas Best or petitioner), was formed as a holding company. The management and control of Arkansas Best resided with Robert A. Young, Jr. (Young) and members of his family. Arkansas Best immediately embarked on a program of expansion with a plan of ultimately becoming a diversified conglomerate.

The envisioned conglomerate was to be composed of businesses from three sectors of the economy: transportation, consumer goods and financial services. Transportation was already represented by ABF, the trucking line. In rapid succession, Arkansas Best then acquired Riverside Furniture Corporation (Riverside), a company engaged in furniture manufacturing, distribution and sales, and Data-Tronics, a company which offered data processing services.

Riverside was to be the core of the consumer goods sector of the conglomerate. Data-Tronics was acquired for a slightly different reason. Arkansas Best desired the aid of a computer in the trucking business but could not afford the cost of the necessary computer. The acquisition of Data-Tronics permitted Arkansas Best to have use of a computer while marketing its services to third parties to reduce costs. Data-Tronics devoted approximately one-half of its services to the needs of Arkansas Best and its subsidiaries.

Arkansas Best then established Arkansas Bandag Corporation (Bandag), a company engaged in new tire sales and tire re-

treading. Bandag also held title to the real estate of Arkansas Best and the other subsidiaries. Initially, ABF (the trucking subsidiary) represented up to one-half of Bandag's tire business but that percentage had declined to approximately five percent by the time of trial.

In the financial services area, Arkansas Best acquired Universal Insurance Company (UIC) and Arkansas Underwriters Corporation (AUC). The companies were useful for the truckline which was "a high utilizer of insurance."

These five subsidiaries — ABF, Riverside, Data-Tronics, Bandag, UIC and AUC — were wholly owned by Arkansas Best. Arkansas Best provided financial planning and, in some cases, accounting and personnel services to its subsidiaries. In return, the companies paid a management fee to Arkansas Best.

From the date of Arkansas Best's incorporation in 1966 until his death in August, 1973, Robert A. Young served as chairman of the board of Arkansas Best. During the period from March, 1967, to April, 1968, Young personally acquired the following stock and security interests in National Bank of Commerce (NBC), a bank located in Dallas, Texas:

Interest	Book Value
Capital Convertible Debentures of NBC	$ 742,600
Contract to purchase 24,534 shares of convertible preferred stock of NBC	1,145,700
209,013 shares of common stock of NBC	5,798,196
Total:	$7,686,496

On June 6, 1968, Young transferred these interests to Young, Inc., a personal holding company incorporated by Young three weeks earlier. These interests, plus $1,000 cash, constituted the assets of Young, Inc.

Three weeks later, on June 29, 1968, Young, Inc. transferred to Arkansas Best all of its stock and securities in NBC. In return, Young, Inc. received 150,000 shares of Series "C" Convertible

Preferred Stock of Arkansas Best[2] plus the assumption by Arkansas Best of Young, Inc.'s liabilities which totaled $7,686,995. The Internal Revenue Service accepted the transaction as a tax-free reorganization.

As a result of the foregoing transaction, Arkansas Best owned 266,614 shares of NBC common stock at the end of 1968.[3] These shares represented 64.97 percent of the outstanding common stock of NBC at that time.

In connection with its acquisition of the bank's stock, Arkansas Best obtained three appraisals of NBC's stock from unrelated investment banking firms. It also obtained five eight-year forecasts from Citibank projecting the expected growth and earnings of the bank.

At the time Arkansas Best acquired the bank stock, Arkansas Best was aware that there were bills pending in Congress which, if enacted, might impact upon its holding of NBC stock. In a notice to shareholders calling a special meeting for June 29, 1968, concerning the proposed acquisition of NBC stock, a proxy statement was included which informed shareholders of the following:

> Bills affecting banking are pending in Congress. The Company is unable to predict whether any such bills will be passed or the effect on the Company's or NBC's business if one or more such bills were passed. However, one such bill, if passed, would amend the Bank Holding Company Act of 1956 to provide that the Company, by virtue of its ownership of NBC shares, would be a bank holding company. With certain exceptions, such Act requires bank holding companies to divest themselves of direct or indirect ownership of voting shares of companies which are not either banks or bank holding compa-

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[2] The stipulated fair market value of the 150,000 shares at the time of the transfer was $1,500,000.

[3] Earlier in 1968, Arkansas Best had separately acquired 3,363 other shares of NBC at a cost of $86,128.

nies. A bank holding company is also prohibited, with limited exceptions, from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any company which is not a bank or from engaging directly or indirectly in business unrelated to the business of banking or controlling banks.

Arkansas Best has a number of reasons for acquiring the stock of NBC. First, the city of Dallas was developing rapidly as a financial center and banks were at the center of the boom. NBC appeared likely to share in this growth and the value of its stock was therefore likely to appreciate.

Second, Arkansas Best planned to make a public offering of its stock. Under generally accepted accounting principles, Arkansas Best could not include NBC, a bank, in the consolidated financial statements of Arkansas Best and its nonbanking subsidiaries. Under the so-called equity method of accounting, however, Arkansas Best was permitted to reflect a pro rata portion (i.e., approximately 65 percent) of NBC's earnings in its financial statements contained in the offering materials. This practice of one-line equity consolidation of earnings was available at the time to any corporate shareholder which owned 20 percent or more of another corporation.

An additional benefit received by ABC was an increase in its aggregate price/earnings ratio. Because banks enjoy relatively high price/earnings ratios compared to certain of Arkansas Best's subsidiaries, Arkansas Best's acquisition of NBC increased its aggregate price/earnings ratio. The higher price/earnings ratio consequently enabled Arkansas Best to obtain a higher price for its shares in the public offering.

Other subsidiary benefits to Arkansas Best from the acquisition of NBC's stock were prestige and acceptance in the Dallas financial community because of association with the bank, added protection from hostile takeover attempts because the bank was subject to federal regulation, and, finally, improved access to financing because the bank stock represented attractive collateral.

NBC did not, however, interact with the Arkansas Best and its subsidiaries in the same way the subsidiaries and Arkansas Best interacted with each other. NBC offered no financing to Arkansas Best or its subsidiaries. Moreover, NBC contributed very little to the conglomerate by way of earnings distributions. Banks typically pay low dividends because they are subject to strict capital retention requirements.

Arkansas Best supplied no management services to NBC and consequently received no management fees from NBC. At any one time, Arkansas Best had no more than three representatives on NBC's Board of Directors which on the average consisted of 20 members. In any event, NBC's Board of Directors had very limited influence over management decisions at the bank because its review was restricted to actions already taken.

On December 31, 1970, Congress enacted the 1970 Amendments to the Bank Holding Company Act. Under the statute and the regulations promulgated thereunder, Arkansas Best was deemed to be "in control" of NBC for purposes of the Bank Holding Company Act, and therefore to be a "bank holding company" as defined in that Act.

Status as a bank holding company required Arkansas Best to either (1) cease making acquisitions of new lines of non-banking businesses or of going-concern acquisitions in its existing lines of non-banking businesses, or (2) divest itself of its entire interest in the bank.

Arkansas Best chose the second alternative and, on July 30, 1971, it filed an irrevocable declaration of divestiture with the Federal Reserve Bank of Dallas. The notice of divestiture declared that Arkansas Best would divest itself of control of NBC by January 1, 1981. Once the notice was filed, Arkansas Best was free to make acquisitions of non-banking businesses.

Arkansas Best carried the bank stock on its financial records as an "investment." As noted previously, generally accepted accounting principles prevented Arkansas Best from including NBC as part of its consolidated group.

In corporate documents, Arkansas Best made repeated references to NBC as an investment. For example, attached to the minutes of the quarterly and annual meeting of the Board of Directors of Arkansas Best, held May 17, 1972, was a "Statement of Corporate Objectives" which included the following goals (emphasis added):

ABC Corporate Structure Viz Diversification

1. Three major components to corporate earnings each subject to separate economic forces and business risks.
2. No single factor to contribute more than 50 percent of revenues as a long run corporate strategy.
3. Direct management control of subsidiaries *(e.g., National Bank of Commerce now treated as an investment of the holding company from an operational standpoint)*.
4. Exploit additional growth potential in trucking, furniture, Bandag and Data-Tronics both internally and by acquisition.

During the period from 1969 through 1974, Arkansas Best participated in a number of capital calls made by NBC in response to concerns of federal regulators that NBC was not adequately capitalized. Also during this period, Arkansas Best acquired additional shares of NBC through stock dividends, purchase and conversion of debentures. These transactions are summarized as follows:

Year	No. Shares Acquired	Cost	Transaction
1969	142,670	$ 3,639,266	Two capital calls
	24,188	723,928	Purchase
1970	—	—	—
1971	43,347	—	Stock dividend
1972	19,072	—	Stock dividend
	95,363	2,407,915	Capital Call
	6,165	616,500	Purchase
1973	23,902	—	Stock dividend
	103,887	2,077,740	Capital Call
	135	13,500	Purchase
	8% Conv. Deb.	3,116,610	Capital Call
1974	124,664	—	Conversion of debentures
	2,402	61,946	Purchase
Total	585,795	$12,657,405	

At the end of 1974, Arkansas Best owned 852,409 shares of the common stock of NBC which represented 65.77 percent of the stock then outstanding.

From 1968 until 1972, the bank appeared to be successful and growing. The capital calls during this period were made to accommodate this growth.

In 1972, Arkansas Best commenced negotiations with Texas Commerce Bancshares to divest itself of the NBC stock in a stock exchange on terms favorable to Arkansas Best. Representatives of Texas Commerce Bancshares examined the loan portfolio of NBC and discovered serious problems. Texas Commerce Bancshares withdrew from the negotiations.

Federal examiners then undertook their own investigation of NBC's financial position. Weak loans in a bank's portfolio are denoted as such by four classifications assigned by the examiners. In order of increasing gravity, the classifications are (1) loans especially mentioned, (2) substandard loans, (3) doubtful loans and (4) loss loans. When a bank has more than 50 percent of its loan portfolio classified as weak loans, the bank is considered a problem bank.

NBC was considered to be a problem bank from 1973 through approximately 1977. The difficulties stemmed primarily from a heavy concentration of loans in the local Dallas real estate industry which suffered a severe collapse at about that time.

In July, 1974, Arkansas Best still held out hope of disposing of the NBC stock at a profit and apparently expected capital gain treatment on such a transaction. The minutes of the Board of Directors meeting for that month summarized the following report by the company's general counsel, Mr. Harper:

> [The Chairman of the Board] stated that he had discussed the desirability of disposing of the company's 60% interest in National Bank of Commerce of Dallas with individual directors and they wished to retain the services of Goldman, Sachs and Company, investment bankers, to assist and advise in efforts to divest NBC.
>
> Mr. Harper reviewed the tax treatment of a one-bank holding company in forced divestiture, stating legislation had been proposed in Congress that banks in such circumstances would not receive rollover tax treatment with no capital gains, but hopefully there would be granted a ten-year period in which to spread the capital gain, or until 1985, whichever comes first. He said we hoped for a method where if the bank would be divested and the money or assets received be invested in a new asset, the capital gain would be delayed until the new asset was disposed of. * * *

The capital calls issued by NBC after 1972 were in response to the loan portfolio problems of the bank. Arkansas Best participated in these capital calls for a number of reasons. First, participation of the controlling shareholder was essential to save the bank and thus Arkansas Best was compelled to participate if it wished to preserve its equity in the bank. Second, failure to participate with the resultant demise of the bank exposed Arkansas Best to litigation by the minority shareholders. Third, permitting the bank to fail would reflect badly on Arkansas Best so that

its sources of financing might be jeopardized and its reputation for skilled management might be tarnished.

On June 30, 1975, Arkansas Best finally sold the bulk of its holdings in NBC stock. It sold 661,000 shares to a group of 63 Texas investors (the "Brooks group"), a block of stock which constituted 51 percent of the outstanding common stock of NBC.

In exchange, Arkansas Best received (1) $1,059,914 in cash, and (2) a note with a face amount of $6,006,176, secured by the 661,000 shares of stock (the "Note"). The fair market value of the Note on June 30, 1975, was $4,878,088.

By December, 1975, it appeared likely that NBC would require even greater infusions of capital than contemplated at the sale. The Brooks group approached Arkansas Best, which still owned 14.7 percent of NBC's outstanding stock, to solicit financial assistance. Arkansas Best refused to make any more efforts to rescue the bank but consented to subscribe to 14.7 percent of the next capital call.

At its directors meeting of December 20, 1975, however, Arkansas Best did accept in principle a compromise suggestion advanced by the Brooks group. The Brooks group suggested that the Note should be sold to some third party who could more certainly assist with NBC's capital needs.

On January 21, 1976, Arkansas Best made a book entry writing down the value of the Note by $4,485,876. The Note was not in default at this time but the directors of Arkansas Best had received some indications that the Brooks group might have some difficulties in honoring its obligation. The accounting entry was made to reflect the underlying book value of the NBC stock securing the Note.

One member of the Brooks group ultimately located a buyer for the Note held by Arkansas Best. On February 9, 1976, Arkansas Best executed a memorandum of agreement with the prospective buyer, Coke L. Gage (Gage). On April 7, 1976, Arkansas Best sold the Note to Gage for $1,652,500. As a condition of this sale,

Arkansas Best acquired an additional 573,953 shares of NBC's common stock in a capital call for $1,233,999.[4]

At approximately the same time as the sale of the Note to Gage, Arkansas Best granted William R. Riley (Riley) an option to purchase its remaining 765,362 shares of NBC stock in annual installments through 1980. Riley or his assignees exercised these options rights as follows:

Year	No. Shares Purchased	Price
1976	15,000	$ 33,000
1977	50,000	110,000
1978	215,226	473,497
1979	215,226	473,497
1980	269,910	593,802
Total:	765,362	$1,683,796

At the close of these transactions, Arkansas Best owned no shares of NBC stock nor any other stock or security interest in NBC.

OPINION

This case raises the question whether the loss realized on the sale of stock by a conglomerate may be characterized as ordinary loss under the Supreme Court's decision in *Corn Products Refining Co. v. Commissioner,* 350 U.S. 46 (1955).

Petitioner is a holding company whose only assets are the stock and securities of other corporations. The holding company is the nucleus of a diversified conglomerate with subsidiaries engaged in the businesses of transportation, consumer goods and financial services.

In 1968, petitioner acquired a controlling interest (approximately 65 percent of the outstanding common stock) in a bank located in Dallas, Texas, The National Bank of Commerce

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[4] In connection with the sale, Arkansas Best incurred sales expenses of $33,050 and legal fees of $5,050.

(NBC). In 1970, Congress enacted certain amendments to the Bank Holding Company Act of 1956, the net result of which was to classify petitioner as a bank holding company by virtue of its ownership interest in NBC.

Status as a bank holding company put petitioner to the following choice: (1) cease making acquisitions of nonbanking businesses, or (2) divest itself of the NBC stock. Petitioner chose the second alternative and, in 1971, filed an irrevocable declaration of divestiture with the Federal Reserve Bank of Dallas which guaranteed divestiture by 1981.

Petitioner sold 51 percent of NBC's outstanding stock in one block in 1975. It disposed of the remaining 14.7 percent in installments over the following five year pursuant to an option granted in 1975. On its Federal income tax return for 1975, petitioner claimed an ordinary loss of $9,995,688 from the disposition of NBC stock.

Section 1221 defines the term "capital asset" to mean any property held by the taxpayer with certain enumerate exceptions. In *Corn Products*, the Supreme Court observed that "[t]he preferential treatment provided by [section 1221] applies to transactions in property which are not the normal source of business income." *Corn Products Refining Co. v. Commissioner, supra*, 350 U.S. at 52. The Court further observed that "[s]ince this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly."

In *Corn Products*, the Court was confronted with transactions which appeared to be ordinary and not capital despite the fact that the property involved did not properly come within any of the exclusions set out in section 1221. The taxpayer in that case was a company engaged in converting corn into starch, syrup and other products. To assure its supply of corn and protect itself against increases in the price of corn, the taxpayer regularly purchased and sold corn futures. The Supreme Court held that losses sustained on these transactions warranted ordinary loss treatment

because Congress intended "that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss." *Corn Products Refining Co. v. Commissioner, supra* at 52.

This judicially-created addition to the exclusions set out in section 1221 was subsequently expanded by the lower courts to include, under certain circumstances, irregular or unique transactions such as dispositions of stock. The principles governing the application of the *Corn Products* doctrine to the sale of securities were summarized by the Court of Claims in a leading case as follows:

> [I]f securities are purchased by a taxpayer as an integral and necessary act in the conduct of his business, and continue to be so held until the time of their sale, any loss incurred as a result thereof may be fully deducted from gross income as a business expense or ordinary loss. If, on the other hand, an investment purpose be found to have motivated the purchase or holding of the securities, any loss realized upon their ultimate disposition must be treated in accord with the capital asset provisions of the Code.
>
> Thus, the circumstances of the transaction (its factual background, the necessities of the particular business involved at the particular time involved, and the intentions of the taxpayer, both at the time the securities were originally purchased and at the time they were disposed of) are of crucial importance in the resolution of these cases. The fact that securities are "property," in the broad sense of that term, is not conclusive.

Booth Newspapers, Inc. v. United States, 157 Ct. Cl. 886, 303 F.2d 916, 921 (1962).

In this case, we must first resolve a threshold issue in order to apply the principles set out above: What is the trade or business of petitioner holding company, if, indeed, a holding company can have a trade or business as that term is used in the Internal Revenue Code?

The term "trade or business" is not defined in the Internal Revenue Code nor in the regulations nor by an authoritative judicial definition in the case law. In 1941, the Supreme Court held that the management of securities by an individual for his own account, even through an elaborate operation requiring an office and staff, was not a trade or business for purposes of section 162. *Higgins v. Commissioner*, 312 U.S. 212 (1941). See *Whipple v. Commissioner*, 373 U.S. 193, 202-3 (1963); *Bodzy v. Commissioner*, 321 F.2d 331 (5th Cir. 1963); *United States v. Byck*, 325 F.2d 551 (5th Cir. 1963); *Deely v. Commissioner*, 73 T.C. 1081 (1980); *Moller v. United States*, 721 F.2d 810 (Fed. Cir. 1983).

The *Higgins* decision prompted the enactment of the predecessor to section 212. Congress sought to permit taxpayers to deduct ordinary and necessary expenses incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income. By its terms, section 212 applies only "[i]n the case of an individual • • •." The failure of Congress to include corporations in the coverage of that section gives rise to a negative implication that all corporations necessarily have a trade or business and, accordingly, do not require the aid of section 212 in order to deduct expenses incurred for the production of income.[5]

Petitioner contends that it is in the trade or business of acquiring and managing going concerns in diverse yet complementary lines of business. Although at first impression it may appear that the acquisition and management of stock holdings in other business constitutes activity peculiarly like that of an investor, there is judicial support for characterizing such activity

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[5] See B. Bittker, Federal Taxation of Income, Estates and Gifts, par. 20.1.2 (1981): "As for corporations, the fact that Congress did not include them in IRC section 212 suggests the possibility that the term 'trade or business' as used by IRC section 162 was thought to be broad enough to embrace a corporation's activities in managing its own investments."

as a trade or business. In a case which squarely addressed this question, the Court of Claims considered what, if any, was the business of Allied Chemical, a holding company:

> The parties have agreed that the acquisition of the stock in American was a part of Allied's business, which at that time was confined to the holding of stocks in other companies. What does the business of a holding company consist of? Briefly stated, it consists of conserving and protecting its holdings, influencing, or directing when it can, the management of the companies in which it holds stock, so as to increase the value of its holdings and the income to be derived therefrom, the collection of dividends, the advantageous disposition of stocks in companies with whose management it is not satisfied; or where it appears desirable to do so, and reinvesting the proceeds, etc.

Allied Chemical Corporation v. United States, 158 Ct. Cl. 267, 305 F.2d 433, 437 (1962).

In another analogous case, this Court found a closed-end investment company to be in a trade or business:

> [Stock] was a part of petitioner's stock in trade as a closed-end investment company. To protect this investment was well within the scope of its business, which consisted of investment in, and management of, securities of other corporations.

Alleghany Corporation v. Commissioner, 28 T.C. 298, 303 (1957).

We accept that petitioner, as a holding company, was in a trade or business defined as the acquisition and management of going concerns in diverse yet complementary lines of business. Our inquiry then, as framed by *Booth Newspapers*, is whether petitioner purchased and held the stock of NBC as an integral and necessary act in the conduct of that business or whether the stock was purchased or held with an investment purpose.

When a taxpayer harbors mixed motives of investment and business purpose, as is often the case, the rule is now settled that "stock purchased with a substantial investment purpose is a capital asset even if there is a more substantial business motive for the purchase." *W. W. Windle Co. v. Commissioner,* 65 T.C. 694, 712 (1976), appeal dismissed 550 F.2d 43 (1st Cir. 1977). Compare *Dearborn Co. v. United States,* 195 Ct. Cl. 219, 444 F.2d 1145 (1971) and *Agway, Inc. v. United States,* 207 Ct. Cl. 682, 524 F.2d 1194 (1975) with *Union Pacific Railroad Co., Inc. v. United States,* 208 Ct. Cl. 1, 524 F.2d 1343 (1975).[6]

When a taxpayer's motive changes between the time of purchase and the time of disposition, whether from investment purpose to business purpose or from business purpose to investment purpose, the character of the gain or loss at disposition of the stock will be capital. This rule "illustrates the fact that corporate stock is normally a capital asset, and that only where both original purpose of acquisition and the reason for continued retention are both devoid of substantial investment intent should the stock be treated otherwise." *W. W. Windle Co. v. Commissioner, supra,* 65 T.C. at 714 n. 15.

In short, the business purpose must persist, without a substantial investment purpose, throughout the purchase and holding period if the gain or loss is to be characterized as ordinary under the *Corn Products* doctrine.

In this case, the acquisition of NBC stock by petitioner may be viewed in two stages: (1) the initial acquisition of a 65 percent interest in 1968, plus the acquisition of additional shares by purchase, capital calls, and stock dividends during the "growth" phase (1969-1972) of the holding period, and (2) the acquisition

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[6] As noted in *W. W. Windle Co. v. Commissioner,* 65 T.C. 694, 710 (1976), the Court of Claims' decision in *Union Pacific Railroad Co., Inc. v. United States,* 208 Ct. Cl. 1, 524 F.2d 1343 (1975) may be viewed as casting doubt on the vitality of *Dearborn Co. v. United States,* 195 Ct. Cl. 219, 444 F.2d 1145 (1971) and *Agway, Inc. v. United States,* 207 Ct. Cl. 682, 524 F.2d 1194 (1975).

of additional shares by purchase, capital calls and stock dividends during the "problem" phase (1973-1976) of the holding period. Arkansas Best's reasons for acquiring and holding the stock in each instance were different.

We find that the acquisitions of NBC stock over the period from 1968 to 1972 were motivated primarily by investment purpose and only incidentally by some business purpose.

Arkansas Best was aware of the rapid development of Dallas, Texas, as a financial center during the early 1960's and was eager to take advantage of the boom. Banks were at the center of the expansion and NBC appeared likely to share in the benefits. Arkansas Best viewed NBC as an attractive investment.

Arkansas Best obtained several appraisals of NBC and forecasts of the bank's earnings. The prospects were very appealing. Had these projections been realized, Arkansas Best's investment in NBC would have experienced strong appreciation. This Court in *W. W. Windle* found projections such as these to bear on investment purpose:

> These projections make it impossible for us to find that there was no substantial investment motive. Had the projections been realized, Nor-West would have been a good investment.

65 T.C. at 705. See *Datamation Services, Inc. v. Commissioner,* T.C. Memo. 1976-252.

The business purposes asserted by petitioner were at most secondary to the investment purpose, e.g., enhancing Arkansas Best's stock price in a planned public offering, prestige in the Dallas financial community and added protection against hostile takeover attempts.

Moreover, Arkansas Best held the stock in such a way as to belie any business purpose at all. NBC was the only subsidiary not wholly owned by Arkansas Best and was never integrated into the "complementary group" of businesses governed by Arkansas Best. The bank was not permitted to supply financing to Arkansas

Best or its subsidiaries and Arkansas Best did not supply management services to or receive a management fee from the bank. The bank contributed very little to the conglomerate by way of earnings distributions. Finally, Arkansas Best exercised very limited influence over the bank's management and, at any one time, never had more than three representatives on NBC's 20-man Board of Directors.

In contrast, the other subsidiaries often acted as suppliers and customers for one another, paid management fees to Arkansas Best, contributed substantial capital to the conglomerate's use, operated under entensive control from Arkansas Best and otherwise existed as integral and complementary units of the conglomerate. See *Booth Newspapers, Inc. v. United States, supra; Union Pacific Railroad Co., Inc. v. United States, supra.*

The divestiture notice in 1971 finally eliminated any remaining prospect of bringing NBC into the complementary system of companies comprising the conglomerate. The directors of Arkansas Best had been aware of this possibility even when the NBC stock was initially acquired in 1968.

The fact that NBC's special status as a bank in part foreclosed its integration into the conglomerate does not alter the hard reality of its separate and distinct character as an investment holding. The bank was not an integral and necessary part of Arkansas Best's business. The actual relationship, not the hoped for or potential relationship, determines whether an asset is part of the everyday operations of the business.

Accordingly, under the principles articulated in *W. W. Windle,* we hold that the character of the loss realized on the disposition of the NBC shares of common stock acquired in the years 1968 through 1972 is capital loss.[7]

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[7] We note in passing that during the time when Arkansas Best still hoped to realize a gain on the sale of NBC pursuant to the divestiture declaration, the directors of Arkansas Best apparently expected the gain to be capital gain. See Findings of Fact, *supra.*

We turn then to the shares of NBC stock acquired by Arkansas Best in the years 1973 through 1976. The reasons for these purchases differed significantly from the reasons for the earlier purchases. We find that these later purchases were made exclusively for business purposes and subsequently held for the same reasons.

After 1972, the bank's poor financial health became alarmingly apparent to Arkansas Best. Because of these difficulties, NBC experienced a need for substantial capital infusions. The probable consequence of Arkansas Best not participating in the capital calls during this period would have been the demise of the bank.

Owning a controlling interest in a bank — a highly regulated, peculiarly public institution — imposed a special responsibility on Arkansas Best. After 1972, Arkansas Best acquired additional shares of NBC stock to meet this obligation and protect its own business reputation.

As a growing conglomerate, Arkansas Best depended upon its good reputation with creditors in order to assure a reliable source of financing for acquisitions. In addition, Arkansas Best's reputation as a conglomerate especially skilled in management determined its standing with other businessmen and in the stock market. (Arkansas Best was listed on the American Stock Exchange beginning in 1969 and on the New York Stock Exchange beginning in 1972.) Association with the failure of a bank would have severely blemished Arkansas Best's reputation in the financial and business communities in which it operates.

Moreover, the demise of the bank would have exposed Arkansas Best (as controlling shareholder) to potentially damaging and costly litigation by minority shareholders.

Expenditures to preserve business reputation are typically currently deductible business expenses. *Dunn & McCarthy, Inc. v. Commissioner,* 139 F.2d 242 (2d Cir. 1943). The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products.*

Arkansas Best was not compelled to make purchases of NBC stock after 1972 nor could it have been motivated by the prospect of obtaining a profitable return on its purchases. The conglomerate carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

It must be observed that a small percentage of shares was acquired during this period by purchase. One purchase was motivated by business purposes and is also entitled to ordinary loss treatment. The purchase was made from the outgoing president of NBC in order to secure his resignation as chief executive officer of NBC and to secure his promise that he would cease disrupting negotiations for the sale of NBC.

The second purchase was from Universal Insurance Company. Petitioner asserts that this purchase was made to protect its subsidiary from regulatory sanctions because "as NBC had ceased paying dividends in 1974, NBC stock no longer constituted an admitted asset in determining the adequacy of Universal's capital and surplus for insurance regulatory purposes." The parties had stipulated, however, that this purchase was made from Universal Insurance Company, "a corporation *subsequently* acquired by ABC [Arkansas Best] as a consolidated subsidiary" (emphasis added). Protection of a subsidiary cannot have been the purpose of this purchase if the insurance company was not a subsidiary at the time of the purchase. Accordingly, these NBC shares must be treated as capital assets along with the initially acquired shares.

Finally, the conversion of the debentures by Arkansas Best in 1974 did not reflect optimistic investment purpose, as respondent contends, but rather an effort to further ease pressures on the bank by removing the burden of making fixed interest payments. The loss on the shares so acquired are entitled to ordinary loss treatment.

In order for the loss to be properly apportioned between its capital and ordinary components as determined above, we must address the second issue raised by petitioner. The loss should be apportioned according to the respective amounts of basis for each of the two sets of stock acquisitions. The amount realized on the disposition of all the shares of NBC stock is undisputed. The basis for the shares acquired in 1973 and subsequent years is likewise undisputed.

The parties disagree, however, whether the basis of the shares initially acquired in 1968 should include the value of 150,000 shares of Arkansas Best preferred stock (stipulated to be $1,500,000) tendered by Arkansas Best in the 1968 transaction. This basis dispute must be resolved in order to determine what portion of the total amount realized should be allocated to the respective capital and ordinary bases. Petitioner argues that the 1968 transaction was a purchase and that the value of the 150,000 shares of Arkansas Best's preferred stock was part of Arkansas Best's cost. Respondent argues that petitioner should be equitably estopped from characterizing the 1968 transaction as anything other than a tax-free reorganization, as petitioner had represented the transaction in 1968. In the alternative, respondent argues that the 1968 transaction was indeed a tax-free reorganization under section 368(a)(1)(C).

Arkansas Best concedes that it intended the 1968 transaction with Young, Inc. to be a tax-free reorganization, and that it represented the transaction as such on its Federal income tax return and to respondent. For the purposes of this case, however, Arkansas Best now urges that the transaction should not have been treated as a tax-free reorganization because the assumption of liabilities in the transaction was excessive and the requisite continuity-of-interest was thereby not preserved. Petitioner cites the following passage from section 1.368-2(d), Income Tax Regs.:

> (1) * * * In determining whether the exchange meets the requirements of 'solely for voting stock', the assumption by the acquiring corporation of liabilities of the transferor corporation,

or the fact that property acquired from the transferor corporation is subject to a liability, shall be disregarded. *Though such an assumption does not prevent an exchange from being solely for voting stock for the purposes of the definition of a reorganization contained in Section 368(a)(1)(C), it may in some cases, however, so alter the character of the transaction as to place the transaction outside the purposes and assumptions of the reorganization provisions. Section 368(a)(1)(C) does not prevent consideration of the effect of an assumption of liabilities on the general character of the transaction* but merely provides that the requirement that the exchange be solely for voting stock is satisfied if the only additional consideration is an assumption of liabilities. [Emphasis added.]

We find it unnecessary to address the merits of this issue raised by petitioner because we hold that petitioner is equitably estopped from asserting that the 1968 transaction with Young, Inc. was other than a tax-free reorganization.

Section 1.1016-6(b), Income Tax Regs., provides that "[i]n determining basis, * * * the principles of estoppel apply, as elsewhere under the Code, and prior internal revenue laws." The doctrine of equitable estoppel is, however, to be sparingly applied in Tax Court litigation and only in special circumstances. Cf. section 1311 et seq.

The traditional elements of estoppel required at common law are as follows.

(1) Conduct amounting to a misrepresentation or concealment of a material fact; (2) actual or imputed knowledge of the misrepresentation by the party to be estopped; (3) absence of knowledge of facts by the party in whose favor estoppel is applied; (4) intention or expectation of the party to be estopped that the representation or concealment will be acted upon by the other party; (5) reliance by the party seeking the estoppel; and (6) detriment to the party seeking the estoppel resulting from his reliance. See 10 J. Mertens, Law of Federal Income Taxation, sec. 60.02 (1976).

Sangers Home for Chronic Patients, Inc. v. Commissioner, 72 T.C. 105, 115 (1979). We find it unnecessary, however, to consider whether each of the above elements of estoppel are present in the instant case because based on the related doctrine of "duty of consistency" we hold petitioner is barred from asserting that the 1968 transaction with Young, Inc., was not a tax-free reorganization.

The duty of consistency, which is sometimes referred to as quasi-estoppel, is based on the theory that the taxpayer owes the Commissioner the duty to be consistent with his tax treatment of items and will not be permitted to benefit from his own prior error or omission. *Southern Pacific Transportation Co. v. Commissioner,* 75 T.C. 497, 838-839 (1980). Although the duty of consistency is akin to estoppel and has the same effect, its application does not require the presence of all the technical elements of estoppel. *Wichita Coca Cola Bottling Co. v. United States,* 152 F.2d 6 (5th Cir. 1945); *Southern Pacific Transportation Co. v. Commissioner, supra.*

In *Bartel v. Commissioner,* 54 T.C. 25 (1970), we were asked to decide whether the duty of consistency applied to the following situation. Taxpayer in *Bartel* was the sole shareholder of a corporation which was liquidated in 1964. During the preceding 11 years, taxpayer had received disbursements from the corporation which were treated by him as loans for income tax purposes. In holding that the duty of consistency prevented taxpayer from asserting that the corporate disbursements were not loans but rather compensation or dividends (and thus requiring taxpayer to compute the portion of the gain on the liquidation attributable to the loans as cancellation of indebtedness), we found particularly relevant the Fifth Circuit Court of Appeals' statement regarding the duty of consistency in *Orange Securities Corp. v. Commissioner,* 131 F.2d 662, 663 (5th Cir. 1942), affg. 45 B.T.A. 24 (1941):

> While it is true that income taxes are intended to be settled and paid annually each year standing to itself, and that omissions, mistakes and frauds are generally to be rectified as of the year

> they occurred, this and other courts have recognized that a taxpayer may not, after taking a position in one year to his advantage and after correction for that year is barred, shift to a contrary position touching the same fact or transaction. When such a fact or transaction is projected in its tax consequences into another year there is a duty of consistency on both the taxpayer and the Commissioner with regard to it, whether or not there be present all the technical elements of an estoppel. • • •*Bartel v. Commissioner, supra* at 29.

In the instant case, we believe the duty of consistency is equally applicable. Petitioner intended and represented that its acquisition of approximately 65 percent of the stock of NBC in 1968 to be a tax-free reorganization under section 368(a)(1)(C). Now, over 15 years later and well beyond the passing of the statute of limitations for that taxable year, petitioner asks us to find that the transaction was not a tax-free reorganization but in fact a purchase. As we stated in *Bartel*, "not only the equities but the practical administration of the law argue against • • • petitioner's request, ' • • •." 54 T.C. at 32. See also *Mayfair Minerals, Inc. v. Commissioner*, 56 T.C. 82, 86 (1971), affd. per curiam 456 F.2d 622 (5th Cir. 1972). Accordingly, we hold the duty of consistency requires Arkansas Best to treat its initial acquisition of NBC as a tax-free reorganization.[8]

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[8] Estoppel and its various counterparts, such as quasi-estoppel, are affirmative defenses which must be pleaded and proved. *Southern Pacific Transportation Co. v. Commissioner*, 75 T.C. 497, 838 (1980); Rule 39. Although respondent failed to formally plead estoppel, his intention to raise the issue was set forth in his trial memorandum filed with the Court and made a part of the record prior to trial. Petitioner was thus given adequate notice that respondent intended to argue the estoppel issue and consequently suffered no detriment due to respondent's failure to formally plead estoppel. Furthermore, petitioner does not argue on opening or reply brief that respondent is barred from asserting the estoppel issue on the ground that it was not formally pleaded.

The third and final issue in this case is whether petitioner is entitled to a bad debt deduction for the partial charge-off of the note acquired in the sale of the bulk of the NBC stock. On June 30, 1975, Arkansas Best sold 51 percent of NBC'c outstanding stock to a group of 63 Texas investors, herein referred to as the "Brooks group." In exchange, Arkansas Best received cash and a note with a face amount of $6,006,176 secured by the 51 percent interest in NBC (the "Note"). On January 21, 1976, Arkansas Best wrote down the value of the Note by $4,485,876 and later took a partially worthless bad debt deduction for the 1975 taxable year, which respondent disallowed.

The deductibility of partially worthless debts is governed by section 166(a)(2), which provides as follows: "When satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction." The language of the statute is permissive rather than mandatory, and whether a debt is partially deductible is a decision committed to the sound discretion of the Commissioner. *Brimberry v. Commissioner*, 588 F.2d 975, 977 (5th Cir. 1979), affg. a Memorandum Opinion of this Court.

A debt may be charged off as partially worthless within a taxable year only if the taxpayer shows with reasonable certainty that a specific, ascertainable portion of the debt was no longer collectible. *Sika Chemical Corp. v. Commissioner*, 64 T.C. 856, 863 (1975). In evaluating a taxpayer's claim of partial worthlessness, the Commissioner must consider all the circumstances, including the value of the collateral securing the debt and the financial condition of the debtor. *Brimberry v. Commissioner, supra* at 977; Sec. 1.166-2(a), Income Tax Regs. The same regulation also provides that the Commissioner's determination will not be disturbed unless it is plainly arbitrary or unreasonable, indicating an abuse of discretion.

Petitioner offers two points in support of the partial worthlessness of the Note in 1975: (1) Arkansas Best had received indications that the Brooks group anticipated difficulties in meet-

ing the capital demands of NBC and (2) the value of the NBC stock securing the Note had declined in value over the six months since the acquisition of the Note.

We find nothing unreasonable or arbitrary in respondent's disallowance of the claimed deduction for partial worthlessness of the Note. The facts relied upon by petitioner are insufficient to amount to a "reasonable certainty" that a portion of the Note was no longer collectible given the circumstances existing in 1975. In late January, 1976, petitioner, as directed by its independent auditors, adjusted the carrying value of the $6 million Note and petitioner's remaining investment in the stock of NBC to a level that would reflect the underlying book value of NBC as determined by audit. Petitioner made the charge off due to pressure from its independent auditors who were concerned not about tax accounting but rather the integrity of petitioner's financial statements.

We do not deem it appropriate to equate the amount of the charge off for partial worthlessness of the Note to the difference between the face amount of the Note and the book value of the NBC stock securing the Note as collateral. Book value, which under the circumstances was perhaps the most expedient method of valuing the stock for financial statement purposes, is by no means to be deemed the equivalent of actual fair market value for tax purposes. Furthermore, since with all its difficulties NBC was by no means insolvent as of the date of the write-down of the Note for financial reporting purposes, so that the value of the NBC stock would have continued to fluctuate up and down from day to day, the fair market value of the stock on the day of the financial report write-down may well have been the next day's irrelevancy. Consequently, petitioner has not convinced us that it has shown with reasonable certainty that a specific, ascertainable portion of the debt was no longer collectible at the time of the charge off. See *Thompson v. Commissioner*, T.C. Memo. 1983-81, and cases cited therein.

Respondent argues in the alternative that since petitioner was negotiating the sale of the Note at the time its value was written down, any loss realized was from the sale of a capital asset rather than from a partial bad debt. Since we have held that no deduction is allowable for partial worthlessness we need not address respondent's alternative argument.

Decision will be
entered under Rule 155.

Supreme Court, U.S.
FILED
FEB 19 1987
JOSEPH F. SPANIOL, JR.
CLERK

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No. 86-751

In the Supreme Court of the United States

OCTOBER TERM, 1986

ARKANSAS BEST CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether 661,000 shares of common stock of a bank that petitioner sold in 1975 were "capital assets" as defined in Section 1221 of the Internal Revenue Code, with the result that the loss realized by petitioner on the sale of the stock was not an ordinary loss, but rather was a capital loss subject to limited deductibility under Section 165(f) of the Code.

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A12) is reported at 800 F.2d 215. The opinion of the Tax Court (Pet. App. B1-B28) is reported at 83 T.C. 640.

JURISDICTION

The judgment of the court of appeals was entered on September 9, 1986. The petition for a writ of certiorari was filed on November 7, 1986. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a diversified holding company. It was organized in 1966 to hold all of the stock of Arkansas Best Freight System, Inc., a successful trucking line operating in the Midwest. Petitioner immediately embarked upon a program of becoming a conglomerate. It acquired all of the stock of various corporations engaged in furniture manufacturing, insurance, data processing, used tire retreading, and new tire sales. The tire subsidiary also held

the real estate occupied by petitioner and its subsidiaries. Petitioner provided financial planning and, in some cases, accounting and personnel services to its subsidiaries, and they in turn paid a management fee to petitioner. The group of companies interacted with each other in a synergistic fashion. Pet. App. A2, B3-B4, B19.

Management and control of petitioner rested with its Chairman of the Board, Robert A. Young, Jr., and with members of his family, until Young's death in 1973. During the period from March 1967 to April 1968, Young personally acquired 209,000 shares of the common stock of the National Bank of Commerce of Dallas, Texas (the Bank), as well as rights to buy additional Bank shares. These shares and rights were transferred to petitioner in June 1968. As a result of these transactions, and of petitioner's purchase of additional Bank shares later that year, petitioner at the end of 1968 owned 266,614 shares of the Bank's common stock, or 64.97% of the then-outstanding common shares. Pet. App. A2, B4-B5.

At the time petitioner acquired the Bank shares, it was aware of pending congressional legislation concerning bank holding companies that, if enacted, would substantially affect corporations that acquired controlling interests in banks. Petitioner had called a special meeting of its shareholders to consider the proposed acquisition of Bank stock, and it had informed them in a proxy statement that the pending legislation, if enacted, would classify petitioner as a bank holding company if it acquired the Bank shares, and might require it, as such, to divest itself of companies that were not banks. On the other hand, petitioner had obtained disinterested appraisals of the Bank stock and projections of the Bank's expected growth and earnings, which indicated that there were a number of reasons for acquiring an equity investment in the Bank. Dallas at the time was developing rapidly as a financial center, and banks were at the center of the

boom, so that it appeared likely that the value of the Bank shares would appreciate. Moreover, petitioner was planning a public offering of its own shares and believed that its financial statements would be rendered more attractive by virtue of owning the Bank stock. The acquisition was also expected to yield favorable results in other respects, including improved price/earnings ratios, enhanced prestige and access to financing in the financial community, and some protection from hostile takeover attempts. Pet. App. B5-B6.

After the acquisition, the Bank did not interact with petitioner and its subsidiaries in the same synergistic fashion as the other subsidiaries. The Bank offered no financing to the corporate group and, as was typical of banks, it contributed little by way of earnings distributions. Petitioner supplied no management services to the Bank, and the Bank did not pay it any management fees. At no time did petitioner have more than three representatives on the Bank's board of directors, which averaged 20 members. Pet. App. B7.

In December 1970, Congress enacted the Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 1760 *et seq.* Pursuant to this new statute, petitioner was classified as a bank holding company and was required either to cease making acquisitions of non-bank businesses or to divest itself of its interest in the Bank. Petitioner chose the latter alternative. On July 30, 1971, petitioner filed with the Federal Reserve Bank of Dallas an irrevocable declaration that it would divest itself of its interest in the Bank within nine and one-half years, that is, prior to January 1, 1981. Petitioner was then free to make further acquisitions of non-bank businesses, and it proceeded to do so. Pet. App. B7.

Between 1969 and 1974, petitioner acquired additional Bank shares by means of various purchases, stock dividends, conversions, and responses to capital calls, all

of which served to increase petitioner's ownership interest only slightly, to 65.77%. Pet. App. B8-B9.[1] The capital calls made by the Bank during this period reflected the concerns of federal regulators that the Bank was inadequately capitalized. From 1968 until 1972 the bank appeared to be successful and growing, and the capital calls were initially designed to accommodate that growth. In 1972, however, after petitioner had commenced negotiations with Texas Commerce Bancshares (TCB) to divest itself of the Bank stock on favorable terms, TCB's representatives examined the Bank's loan portfolio and discovered serious problems. The negotiations were thereupon terminated. Subsequently, federal examiners undertook their own examination and classified the Bank as a problem bank, primarily because it had a heavy concentration of loans in the Dallas real estate business, which suffered a severe collapse at about that time. Pet. App. A2-A3, B9.

The capital calls issued by the Bank after 1972 were in response to these loan-portfolio problems. Petitioner responded to the post-1972 capital calls for a number of reasons. First, participation of the majority shareholder was essential to save the Bank, and thus petitioner was compelled to participate if it wished to preserve its equity stake. Second, failure to participate, with the resultant demise of the Bank, likely would have exposed petitioner to litigation by minority shareholders. Third, permitting the Bank to fail would reflect badly on petitioner so that

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[1] Some of the listed transactions that the Tax Court referred to as capital calls were referred to in a stipulation of facts submitted by the parties as exercises of stockholder pre-emptive rights (Stip. ¶ 20). Presumably, when added capital was required, shares were offered to existing shareholders on a prorata basis. Presumably, also, the stock dividends served the purpose of increasing capital by capitalizing earnings. That would explain why, although petitioner more than tripled the number of shares that it owned during this period, its percentage ownership increased only from 64.97% to 65.77%.

its sources of financing might be jeopardized and its reputation for skilled management might be tarnished. Pet. App. B10-B11.[2]

Notwithstanding the Bank's problems, petitioner still hoped, at least as late as July 1974, to dispose of its Bank stock at a profit, and it apparently expected capital gain treatment on such a disposition. At a meeting of petitioner's board of directors in that month, its general counsel reviewed the possible tax treatment of a bank stock divestiture. He expressed the hope that the anticipated capital gain could be spread over a ten-year period, or, alternatively, that the proceeds of sale could be invested in a new asset and that taxation of the capital gain could be delayed until the disposition of the new asset (Pet. App. B10). Throughout the period in question, petitioner carried the bank stock in its financial records as an investment (*id.* at B7).

On June 30, 1975, petitioner sold to a group of investors 661,000 shares of Bank stock, representing 51% of the outstanding common stock. That left petitioner with a 14.7% stake. For the 661,000 shares sold, petitioner received cash and other consideration with an aggregate value in excess of $5 million (Pet. App. B11). It was stipulated that petitioner's basis in the 661,000 shares was about $15 million (Stip. ¶ 7).

On a consolidated federal income tax return filed on behalf of itself and its subsidiaries for 1975, petitioner claimed a deduction for an ordinary loss in the amount of $9,995,688 from the sale of the 661,000 shares of Bank stock. In his notice of deficiencies, the Commissioner disallowed the claimed ordinary loss deduction, finding

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[2] The existence of these separately stated reasons was a finding of fact made by the Tax Court (Pet. App. B10-B11). In its opinion, however, the Tax Court made the somewhat contradictory statement that the post-1972 acquisitions were "solely to preserve [petitioner's] business reputation" (*id.* at B21).

that the loss resulting from the sale was a capital loss, subject to the limitations of Sections 165(f) and 1211(a) of the Internal Revenue Code.[3] Those sections generally provide that a corporate taxpayer may deduct capital losses only to the extent of its capital gains, while permitting excess capital losses to be carried over to other years.

2. Petitioner sought redetermination of the deficiencies in the Tax Court. The Tax Court agreed with the Commissioner that the Bank shares acquired before the end of 1972 were capital assets whose disposition gave rise to a capital loss. But the court held that most of the Bank shares acquired after 1972 were non-capital assets whose disposition gave rise to an ordinary loss. In so holding, the Tax Court accepted as its point of departure the Court of Claims' opinion in *Booth Newspapers, Inc.* v. *United States,* 303 F.2d 916 (1962). That decision and various cases following it had interpreted this Court's opinion in *Corn Products Refining Co.* v. *Commissioner,* 350 U.S. 46 (1955), to support the conclusion that securities disposed of by a business should be treated as a non-capital asset if they were purchased and held "as an integral and necessary act in the conduct of that business [rather than] purchased and held with an investment purpose." Pet. App. B16.

Extending the rationale of this so-called "*Corn Products* doctrine" to the facts here, the Tax Court stated that petitioner's acquisitions of Bank shares after 1972 were designed "to preserve [petitioner's] business reputation" and that expenditures for that purpose are typically deductible as business expenses (Pet. App. B20-B21). The court accordingly found that petitioner's post-1972 acquisitions of shares were "motivated by business purposes" (*id.*

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[3] Unless otherwise noted, all statutory references are to the Internal Revenue Code (26 U.S.C.), as amended (the Code or I.R.C.).

at B21) and from that premise concluded that the loss suffered upon the disposition of those shares in 1975 was an ordinary loss (*id.* at B20-B21). With respect to petitioner's acquisitions of Bank stock during 1968-1972, by contrast, the Tax Court concluded that the acquisitions "were motivated primarily by investment purpose" (*id.* at B18) and hence that the disposition of those shares in 1975 gave rise to capital losses (*id.* at B18-B19).

3. The Commissioner appealed with respect to the Tax Court's determination that some of the Bank shares sold in 1975 were non-capital assets. Petitioner cross-appealed with respect to the Tax Court's determination that certain shares were capital assets. The court of appeals, by a 2-1 vote, held in favor of the Commissioner, reversing "insofar as the Tax Court allowed ordinary loss treatment for any of the capital stock transactions" (Pet. App. A2), but affirming the Tax Court's decision in all other respects (*id.* at A1-A11).

The court of appeals concluded that none of petitioner's shares of Bank common stock fell within the definition of "capital asset" set forth in Section 1221 of the Code. That section generally defines a "capital asset" as "property held by the taxpayer (whether or not connected with his trade or business)," with five specific exceptions. The court concluded that the Bank shares satisfied the general definition in Section 1221 and, as petitioner conceded, that the shares did not fall within any of these specific statutory exceptions. Pet. App. A4-A8. The court of appeals acknowledged that some courts had "taken the position that capital stock is not a capital asset when acquired to assure a supply of raw materials vital to the taxpayer's business, to preserve an existing business, or even to pursue new business" (*id.* at A8 (citing cases)). But the court expressly rejected these decisions, characterizing them as "misbegotten" (*id.* at A10) and noting that they "lack a basis in the statutory language" (*id.* at A9).

The court of appeals specifically addressed the Fifth Circuit's recent decision in *Campbell Taggart, Inc.* v. *United States,* 744 F.2d 442 (1984), which it found to be "[t]he case most closely analogous to the case before [it]" (Pet. App. A9). That case, like this one, involved a holding company's purchase and sale of shares of stock in another company consummated in order to protect the holding company's "good will and reputation" (*ibid.*). The court of appeals below stated that it "d[id] not agree with the Fifth Circuit's interpretation of section 1221" in *Campbell Taggart,* which allowed the taxpayer there to take an ordinary loss on the sale of the shares in question (Pet. App. A10). To the contrary, the court below emphasized that it "d[id] not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221" (*ibid.*).[4]

DISCUSSION

Petitioner contends that the court of appeals erred in holding that its shares of stock in the Bank were "capital assets" whose disposition gave rise to a capital, rather than an ordinary, loss. We disagree with this contention. In our view, Section 1221 of the Code clearly provides that capital stock not falling within one of the statute's specific exceptions must be considered a capital asset, and the court of appeals' conclusion to this effect is fully consistent with the decisions of this Court. We do agree with petitioner, however, that the courts of appeals are in disarray on this issue and that the decision below directly conflicts with decisions in other circuits. Because this is an

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[4] In this regard, the court of appeals was not speaking of securities held as inventory by a securities dealer, which would be excluded from the definition of a "capital asset" under the exception for "inventory" set forth in Section 1221(1). See 2 B. Bittker, *Federal Taxation of Income, Estates, and Gifts* § 51.2.2, at 51-8 to 51-12 (1981).

important and recurring question, we accordingly do not oppose a grant of certiorari in this case.

1. The statutory framework that governs this case is unambiguous. Section 165(a) of the Code allows as a deduction "any loss sustained during the taxable year not compensated for by insurance or otherwise." That general rule is qualified by other subsections, including Section 165(f), which provides that "[l]osses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212." And Section 1211(a) of the Code provides: "In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges."[5]

The question presented here thus turns on the meaning of the phrase "capital assets." Section 1221 provides the statutory definition: "For purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (*whether or not connected with his trade or business*)" (emphasis supplied). This all-inclusive definition is then followed by five specific exceptions,[6] none of which is claimed to embrace the Bank shares involved here. It is true that these five exceptions—which cover among

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[5] If Section 1211(a) is operative, Section 1212(a) permits a carryback of capital losses for three years, and a carryforward for five years; capital losses thus carried over may be applied against capital gains in such earlier or later years. The amount of a loss from the sale or exchange of property is determined pursuant to Section 1001(a) and (b).

[6] The body of this definition has not been substantially changed since its enactment in 1924. See Revenue Act of 1924, ch. 234, § 208(a), 43 Stat. 453. The latter four exceptions were added subsequently. The first exception, which includes "stock in trade * * * which would properly be included in the inventory of the taxpayer," was slightly amended in 1934 by the addition of the phrase "to customers" and the word "ordinary." Revenue Act of 1934, ch. 277, § 117(b), 48 Stat. 680.

other things inventory, depreciable or real property used in a trade or business, and business accounts and notes receivable—remove the bulk of business-related assets other than stock and securities from the body of the statutory definition. To that extent, these exceptions qualify the statute's parenthetical clause in a specific and limited fashion. But it is clear that these five exceptions establish no general rule removing *all* business-related assets from the statutory definition, since such a rule would strip the parenthetical clause of its meaning. That clause obviously contemplates that *some* property connected with a trade or business can be a capital asset, and the clause provides that such property *is* a capital asset unless it is covered by one of the five specific exceptions. If one looks simply at the text of the statute, therefore, it seems clear that the 661,000 shares of Bank stock sold by petitioner in 1975 were "capital assets," and hence that the resulting loss was a capital loss controlled by the provisions of Section 1211(a).

Petitioner nevertheless contends that the terms of the statute do not control here because of what it calls "the *Corn Products* doctrine" (Pet. 10). Petitioner refers to a series of lower-court decisions that have construed this Court's opinion in *Corn Products Refining Co.* v. *Commissioner,* 350 U.S. 46 (1955), to support the proposition that the characterization of capital stock as a capital asset turns on the extent to which the taxpayer's acquisition of the shares had a "business" rather than an "investment" purpose. We agree with the court of appeals (Pet. App. A10), and disagree with petitioner (Pet. 15-19), on this point. In our view, *Corn Products* does not justify any deviation from the specific terms of Section 1221.

In the *Corn Products* case, the taxpayer was engaged in the business of refining and selling corn products, but it had a disproportionately small storage capacity for raw corn for an operation of its size. To protect itself against

sharp increases in corn prices, the company, when prices appeared favorable at harvest time, would establish a long position in corn futures so as to assure an adequate supply of raw corn at a stable price. It viewed this approach as preferable to making large expenditures for additional storage facilities. The company would take delivery on these futures contracts to the extent it needed more corn for its manufacturing operations, and it would sell off the remainder of the futures in early summer if no corn shortage appeared imminent. If shortages appeared, however, it sold futures only as it bought spot corn for grinding. In 1940, the company netted a profit of $680,000 in corn futures, and in 1942 it netted a loss of $110,000. See 350 U.S. at 48-49. The company claimed that its futures contracts were "capital assets" within the meaning of Section 1221's predecessor, contending that it was acting as a "legitimate capitalist" in its futures transactions. The Commissioner disagreed, and the debate between the parties focused on whether the futures transactions constituted hedging transactions, which for many years had been "regarded as insurance rather than a dealing in capital assets" (350 U.S. at 52).

The court of appeals decided against the taxpayer, affirming a Tax Court decision that had resolved the case on other grounds. 215 F.2d 513 (2d Cir. 1954). The court of appeals' opinion made clear that the basis of its decision was the specific statutory exception for business "inventory" (215 F.2d at 516):

> The tax treatment of hedges, then, is not a "judge-made exception" to [the predecessor of Section 1221]; it is simply a recognition by the courts that property used in hedging transactions comes within the exclusions of the section.
>
> * * * * *
>
> Futures contracts were entered into to stabilize inventory costs and thus protect profit, and whether com-

plete or only partial insurance was thereby obtained is simply a difference in degree, not in kind.

This Court affirmed the court of appeals' decision in *Corn Products*, and there is no justification for viewing this Court's opinion as creating a judge-made exception to the specific definition of "capital asset" enacted by Congress. Rather, we believe that this Court's holding in *Corn Products*, in line with the explicit statement by the court of appeals there, was that the corn futures in the circumstances of that case fell within the "inventory" exception to what is now Section 1221. See 350 U.S. at 53-54. And this reading of *Corn Products* is strongly supported by this Court's subsequent statement in *Malat* v. *Riddell*, 383 U.S. 569, 572 (1966), that "[a] literal reading of [Section 1221] is consistent with [its] legislative purpose." See also *United States* v. *Mississippi Chemical Corp.*, 405 U.S. 298 (1972). Accordingly, we see no justification for reading *Corn Products* as creating an additional "business purpose" exception to the specific terms of Section 1221.

2. We agree with petitioner, however, that several courts of appeals have embraced the notion that there is such a judicial exception to the statutory definition of "capital asset." The source of this line of cases is *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916 (Ct. Cl. 1962), where the court found that stock in a paper company purchased in order to assure a supply of newsprint in a time of shortage could be treated as a non-capital asset. The court relied on a passage in the *Corn Products* opinion—a passage in which this Court described the operation of Section 1221's predecessor in general terms—as establishing a new judge-made addition to the list of exceptions contained in the statute. See 303 F.2d at 920, citing 350 U.S. at 51-52. In the Court of Claims' view, this nonstatutory exception enables securities to become a non-capital asset if they have been acquired "by a taxpayer as an integral and necessary act in conduct of his business,"

whereas the identical securities would remain a capital asset if "an investment purpose be found to have motivated the [taxpayer's] purchase or holding of [them]" (303 F.2d at 921).

The Court of Claims' theory in *Booth Newspapers* was adopted and applied by the Sixth Circuit in *Steadman* v. *Commissioner*, 424 F.2d 1, 5, cert. denied, 400 U.S. 869 (1970).[7] In that case, capital stock was acquired by a taxpayer in order to gain access to technical staff, and the shares were held to be non-capital assets. More recently, in *Campbell Taggart, Inc.* v. *United States*, 744 F.2d 442 (1984), the Fifth Circuit held that the purchase and sale of certain shares of stock by a holding company in order to preserve its business reputation gave rise, in the particular circumstances of that case, to an ordinary loss. The Fifth Circuit canvassed the line of cases descending from *Booth Newspapers* and reformulated the inquiry for determining when property is a capital asset as "whether the asset was acquired with a business purpose or an investment purpose" (744 F.2d at 457). Other courts have used varying formulations and have reached varied results. See generally 2 B. Bittker, *Federal Taxation of Income, Estates, and Gifts* § 51.10.3, at 51-61 to 51-69 (1981).[8]

As petitioner contends, the decision below conflicts with these decisions. The court of appeals in this case has rejected the idea that there is any judge-made exception to

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[7] Justices Harlan, Stewart and Blackmun dissented from the denial of the Commissioner's petition for a writ of certiorari (400 U.S. 869 (1970)).

[8] The Tax Court, seeking to minimize the uncertain inquiry into corporate motives necessarily engendered by the approach described in the text, has held that securities should be treated as a capital asset as long as the taxpayer had any "substantial investment motive" in acquiring them. See *W.W. Windle Co.* v. *Commissioner*, 65 T.C. 694 (1976), appeal dismissed, 550 F.2d 43 (1st Cir.), cert. denied, 431 U.S. 966 (1977). The Fourth Circuit has reasoned similarly. See *Wright* v. *Commissioner*, 756 F.2d 1039, 1042 (1985).

Section 1221's plain terms, holding that capital stock is a capital asset unless it falls within one of the five specific statutory exceptions. In our view, a decision of this Court is required to resolve the increasing divergence in the courts of appeals with respect to the proper interpretation of the *Corn Products* decision. The tax treatment of dispositions of securities arguably acquired for any non-investment business purpose is an important and recurring issue, and the amounts in controversy characteristically are substantial. Moreover, although the Tax Reform Act of 1986 has eliminated for the future the preferential rate of tax on long-term capital gains (see Pub. L. No. 99-514, §§ 301, 311 (Oct. 22, 1986)), the *Corn Products* issue retains its full significance because the new Act has not altered the limitations on the deductibility of capital losses. See 2 H.R. Conf. Rep. 99-841, 99th Cong., 2d Sess. 105-106 (1986). And it is of course in the context of losses that the question presented here typically arises. Accordingly, we do not oppose the grant of certiorari in this case.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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No. 86-751

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

JOINT APPENDIX

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* The opinions of the United States Tax Court and the United States Court of Appeals for the Eighth Circuit appear in the Appendix to the Petition for Writ of Certiorari at B-1 and A-1, respectively.

CHRONOLOGICAL LIST OF RELEVANT DOCKET ENTRIES

October 9, 1980 — Petitioner Arkansas Best Corporation and Subsidiaries files original petition in the United States Tax Court.

December 5, 1981 — Respondent Commissioner of Internal Revenue files original answer.

June 6, 1983 — Bench trial commences.

October 29, 1984 — Memorandum findings of fact and opinion issued by Judge Nims of the United States Tax Court.

March 5, 1985 — Decision entered by Judge Nims of the United States Tax Court.

May 31, 1985 — Respondent files notice of appeal to the United States Court of Appeals for the Eighth Circuit.

June 27, 1985 — Petitioner files notice of appeal to the United States Court of Appeals for the Eighth Circuit.

February 13, 1986 — Oral argument heard by the United States Court of Appeals for the Eighth Circuit.

September 9, 1986 — Opinion issued by the United States Court of Appeals for the Eighth Circuit.

September 25, 1986 — Petitioner files motion to stay issuance of mandate.

October 8, 1986 — Order to stay issuance of mandate pending certiorari proceedings issued by the United States Court of Appeals for the Eighth Circuit.

November 7, 1986 — Petitioner files petition for writ of certiorari in the United States Supreme Court.

February 19, 1987 — Respondent files brief on petition for writ of certiorari.

March 23, 1987 — Petition for writ of certiorari granted by the United States Supreme Court.

UNITED STATES TAX COURT

ARKANSAS BEST CORPORATION AND SUBSIDIARIES, *Petitioner,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Docket No. 18954-80

STIPULATION OF FACTS/DOCUMENTS

The parties in the above-entitled action, by and through their attorneys of record, stipulate and agree that the following facts are true and correct and may be offered into evidence in the trial of this case, subject to the right of the parties to introduce other and further evidence not inconsistent with this stipulation. The parties further stipulate that the Exhibits attached hereto and described hereafter meet all requirements of authentication, identification and admissibility within the meaning and scope of the Federal Rules of Evidence. No stipulation as to relevance or materiality of any of the subsequent paragraphs is to be inferred by the parties' agreements as to authenticity.

1. Arkansas Best Corporation ("ABC") is a Delaware corporation with principal offices at 1000 S. 21st Street, Fort Smith, Arkansas 72901. ABC is a publicly-held corporation. During the period from 1968 to 1975, ABC owned 50% or more of the stock in the following businesses:

(a) Arkansas Best Freight System, Inc., now ABF Freight System, Inc., a company engaged in interstate trucking;

(b) Riverside Furniture Corporation, a company engaged in furniture manufacturing, distribution and sales;

(c) Data-Tronics Corp., a company engaged in data processing services;

(d) Arkansas Bandag Corporation, now ABC Treadco, Inc., a company engaged in new tire sales and retreading; and

(e) National Bank of Commerce, Dallas, Texas ("NBC"), engaged in banking.

2. Petitioner timely filed consolidated income tax returns with the Internal Revenue Service in Austin, Texas for each of the calendar years in issue (1969 through 1976). Copies of the tax returns for the taxable years 1969 through 1976 are attached hereto as Exhibits 1-A, 2-B, 3-C, 4-D, 5-E, 6-F, 7-G and 8-H, respectively.

3. Attached hereto as Exhibit 9-I is a copy of the Statutory Notice of Deficiency ("S/N") dated July 10, 1980, which was timely mailed to petitioner.

4. All issues set forth in the S/N except the following have been settled:

(a) The $9,995,688 claimed ordinary loss disallowed by the Commissioner, which ABC had claimed in connection with the June 30, 1975, sale to F. E. Anderson, et al., of 661,000 shares of the common stock of NBC, which the Commissioner treated as a capital loss. (S/N adjustment (f), p. 9, Schedule 1-A. and Schedule 1-B, item (f), p. 11).

(b) The $4,353,676 ordinary loss claimed by ABC in connection with its April 2, 1976 sale to Coke L. Gage of a $6,006,176 note of F. E. Anderson, et al., received as a portion of the total consideration for the 661,000 shares of NBC common stock referred to in paragraph 5(a) above.

(S/N adjustment (i), p. 7, and Schedule 1-C, item (i), p. 8). In addition, Petitioner incurred legal expenses of $5,050 and a commission expense of $33,050, for a total claimed ordinary loss of $4,391,776.

5. In addition to the issues set forth in paragraph 5 above, petitioner asserts that it is entitled to an unclaimed ordinary loss not claimed on its tax return for the year 1976, in the amount of $493,982.00. Said loss occurred in connection with a sale by ABC of 15,000 shares of NBC's common stock to William R. Riley. (See Petition paragraph 4(c) and 5(a)(xv) and (a)(xvi)). The Respondent contends that the loss is a capital loss.

6. The parties not only disagree as to the character of the losses set forth in paragraphs 4(a) and 5, but also as to the amounts of such losses, as set forth in paragraphs 7 and 8 below:

7. Petitioner's basis for the 661,000 shares of NBC stock sold in June, 1975 is $16,062,286 if petitioner is entitled to include in its basis the pro rata portion of the 150,000 shares of $10.00 par preferred stock transferred to Young, Inc. and petitioner's basis is $14,966,299 if petitioner is not entitled to include the preferred stock in its basis.

8. Petitioner's basis for the 15,000 shares of NBC stock sold to William R. Riley in 1976 is $526,982 if petitioner is entitled to include in its basis the pro rata portion of the 150,000 shares of $10.00 par preferred stock transferred to Young, Inc. and petitioner's basis is $419,333 if petitioner is not entitled to include the preferred stock in its basis. Petitioner incurred sales expenses of $660 and legal expenses of $2,525 in connection with this sale.

9. From the date of ABC's incorporation in 1966 until the date of his death, in August 1973, Robert A. Young, Jr.

(hereinafter "Mr. Young") served as the Chairman of the Board of ABC. In March of 1967 Mr. Young acquired (i) 190,000 shares of common stock of NBC, and (ii) a promissory note from Mr. J. G. Lawrence in the principal amount of $468,869.22 plus accrued interest of $31,122.31 secured by 11,916 shares of NBC common stock, from Mr. Troy Post in a private sale in which neither NBC nor Mr. Post requested an investment letter from Mr. Young. Mr. Young paid Mr. Post $5,933,991.53 in total consideration, including a cash payment of $933,991.53 and a note for $5,000,000. A copy of the agreement of sale between Messrs. Young and Post, together with copies of related exhibits and correspondence, are attached as Exhibits 10 through 15. Mr. Young obtained the cash necessary for the purchase through a $950,000 loan from the First National City Bank, New York, New York. Subsequently, Mr. Lawrence sold the NBC common stock securing the $468,869 note and used the proceeds of those sales together with other funds, to satisfy his indebtedness to Mr. Young. Mr. Young, in turn, used the proceeds to reduce the principal amount of his indebtedness to Mr. Post. By August 23, 1967, the principal of the $5,000,000 note due Mr. Post had been reduced to $4,496,955.

10. In December 1967 Mr. Young obtained an option to acquire 24,534 shares of 6% Convertible Preferred Stock of NBC from Messrs. Michaux Nash, Sr., and Michaux Nash, Jr., in consideration of Mr. Young's guarantee of debts totalling $1,145,700 then secured by that stock. A copy of the letter agreement establishing this option is attached as Exhibit 16. These shares were convertible into an equal number of shares of the common stock of NBC, and together with the 190,000 shares earlier acquired from Mr. Post, gave Mr. Young common stock, or the right to acquire common stock, totaling 51¾% of the outstanding voting stock of NBC at December 31, 1967.

11. In March 1968 Mr. Young acquired 19,013 shares of NBC common stock from NBC in a preemptive rights offering for $351,741.

12. In April 1968 Mr. Young acquired $742,600 principal amount of 5.5% Capital Convertible Debentures of NBC at par from NBC. These capital convertible debentures were convertible into 29,704 shares of NBC common stock.

13. Both the 19,013 shares of NBC common stock acquired in March 1968 and the $742,600 principal amount of 5.5% capital convertible debentures of NBC acquired in April 1968 were acquired for cash. Funds for these acquisitions were borrowed from First National Bank of Fort Worth.

14. On June 6, 1968, Mr. Young transferred all his stock and security interests in NBC to Young, Inc., in exchange for 500,000 shares of the common stock of Young, Inc., plus Young, Inc.'s agreement to assume all indebtedness incurred by Mr. Young in connection with his acquisition of the aforesaid stock and security interests. Attached as Exhibit 17 is a copy of the Agreement for Exchange of Stock between Mr. Young and Young, Inc., dated June 6, 1968.

15. Young, Inc., was a personal holding company as that term is defined under the Internal Revenue Code. Young, Inc., organized under the laws of the State of Arkansas, was incorporated on May 20, 1968. A copy of Young, Inc.'s articles of incorporation is attached as Exhibit 18. From the date of its incorporation until its dissolution on November 2, 1973, all of the stock of Young, Inc. was owned by Mr. Young or by his estate. Young, Inc. was formed to serve the general business

and charitable purposes of Mr. Young. On June 28, 1968, assets of Young, Inc., consisted of the following:

Assets	Book Value
Cash	$ 1,000.00
Capital Convertible Debentures of NBC	742,600.00
Contract to purchase 24,534 shares of convertible preferred stock of NBC	1,145,700.00
209,013 shares of common stock of NBC	5,798,196.00

16. On June 29, 1968, pursuant to an Agreement for Exchange of Stock dated June 14, 1968, and following approval of that Agreement by ABC's Board of Directors and shareholders, Young, Inc. transferred to ABC all of its stock and securities of NBC (including 209,013 shares of common stock, 29,704 units of convertible debentures with a par value of $742,600, which ABC converted into 29,704 shares of common stock immediately upon acquisition, and a contract to purchase 24,534 shares of convertible preferred stock, which ABC exercised and converted to 24,534 shares of common stock prior to December 31, 1968) and received 150,000 shares of Series "C" Convertible Preferred Stock of ABC, together with ABC's assumption of Young, Inc.'s outstanding obligations aggregating $7,686,995 ($4,496,955 then owed to Troy Post under the $5,000,000 note referred to in paragraph 6 above; $950,000 owed to the First National City Bank, New York, New York, incurred in connection with Mr. Young's acquisition of Mr. Post's stock; $1,094,340 owed to First National Bank, Fort Worth, Texas, first incurred by Mr. Young to acquire the $742,600 in capital convertible debentures and the 19,013 shares of NBC common stock referred to in paragraphs 11 and 12 above; and $1,145,700 in the form of a guarantee for debt owed to First National Bank, Dallas, Texas, first incurred by

Mr. Young in connection with the option to acquire 24,534 shares of NBC stock obtained in December, 1967). A copy of the June 14, 1968 Agreement for Exchange of Stock, with appendices, between Young, Inc. and ABC is attached as Exhibit 19. Attached are copies of the following minutes and transcripts of meetings approving the sale: Minutes of June 14, 1968, meeting of ABC's executive committee (Exhibit 20); Minutes of June 28, 1968, meeting of ABC's board of directors (Exhibit 21); Minutes of the June 29, 1968, special meeting of ABC's shareholders (Exhibit 22); Transcript of the June 28, 1968, meeting of ABC's board of directors (Exhibit 23); and Transcript of June 29, 1968, special meeting of ABC's shareholders (Exhibit 24). Attached as Exhibit 25 is a copy of the proxy statement issued to ABC's shareholders in connection with the June 29, 1968, special meeting of shareholders. Later in 1968, ABC exercised its option to acquire the 24,534 shares of 6% Convertible Preferred Stock of NBC described above, paying Messrs. Nash, Sr. and Nash, Jr. $1,145,700 for such stock, and exercised its conversion rights. In addition, ABC also acquired the following shares of NBC stock in 1968:

Months	Number of Shares	Cost
February	2,071	$55,173
April	207	3,830
June	1,085	27,125

As a result of these transactions, ABC acquired 266,614 shares of NBC common stock, which constituted 64.97 percent of the outstanding common stock of NBC at December 31, 1968.

17. Young, Inc. gave ABC an investment letter with respect to the ABC stock it received under the June 14, 1968, agreement for exchange of stock. A copy of that letter appears as

Exhibit 26. ABC did not give Young, Inc. an investment letter in connection with the transaction.

18. On March 18, 1969, ABC's stock was listed on the American Stock Exchange. Previously, its stock has been traded in the over-the-counter market. On December 20, 1972, ABC stock was listed on the New York Stock Exchange.

19. ABC obtained opinions concerning the value of NBC's common stock from the investment banking firms of Brown, Allen & Co., Almon & Co. and Ling & Co., Inc., prior to its June 29, 1968 acquisition of the assets of Young, Inc. Copies of those opinions are attached as Exhibits 27, 28 and 29. ABC also obtained an opinion from Ling & Co., Inc. concerning the value of the 150,000 shares of preferred stock. A copy of that opinion is attached hereto as Exhibit P(F).

20. During the years 1969 through 1974, the Comptroller made a series of determinations that NBC's capital was inadequate. Following negotiations involving the Comptroller and the Board of Directors of NBC, ABC exercised its preemptive rights in a series of stock offerings designed to increase NBC's capital ("capital calls"). The concerns of the bank examiners were expressed orally and in writing. A letter to NBC from Billy C. Wood, Deputy Regional Administrator of National Banks, dated December 29, 1970, indicated that NBC's capital structure was inadequate. A copy of that letter is attached as Exhibit 30.

21. During 1969, ABC participated in two NBC capital calls made to address the concerns of federal bank regulators that NBC was not adequately capitalized. In those calls, ABC acquired an additional 142,670 shares of NBC common stock at an aggregate cost of $3,639,266. In the first call, ABC acquired 70,154 shares at an aggregate cost of $1,753,850 ($25 per share). In the second call, ABC acquired 72,516 shares at an aggregate cost of $1,885,416 ($26 per share). In addition, ABC

also acquired 24,188 shares of NBC stock for aggregate consideration of $723,928. At December 31, 1969, ABC owned 433,472 shares of NBC's common stock, constituting 60.43 percent of NBC's common stock outstanding on that date.

22. During 1970, ABC made no additional acquisitions of NBC stock. ABC owned 433,472 shares of NBC's common stock at December 31, 1970.

23. On December 31, 1970, Congress enacted the 1970 Amendments to the Bank Holding Company Act. Under the Amendments to the Act and regulations promulgated thereunder (specifically 12 C.F.R. #225.2 (1981)), ABC was deemed to be "in control" of NBC for purposes of the Bank Holding Company Act, and therefore to be a "bank holding company" as defined in 12 U.S.C.A. #1841(a)(1) (1980).

24. Pursuant to the provisions of the Bank Holding Company Act, as amended in 1970, on or about July 30, 1971, ABC filed "an irrevocable declaration" with The Federal Reserve Bank of Dallas, to cease to be a bank holding company by divesting itself of control of the National Bank of Commerce, Dallas, Texas, not later than January 1, 1981. A copy of the declaration and the resolution by the Board of Directors of ABC are attached as Exhibit 31.

25. After filing its "irrevocable declaration" of intent to divest itself of its controlling interest in NBC, ABC through its subsidiaries acquired interests in the following businesses:

(a) Interstate Trucking

(1) Youngblood Truck Lines, Inc. (1971)

(2) Nicklaus Transfer & Storage Co. (1974)

(4) Navajo Freight Lines, Inc. (1978)

(5) Western Gillette (1979)

(6) East Texas Motor Freight (1982)

(b) Furniture

(1) Coffey Furniture Industries, Inc. (1973)

(c) Data Services

(1) Norvel Systems, Inc. (1972)

(d) Tire Retreading

(1) Southwest Bandag, Inc. (1977)

(2) Uniroyal of Dania, Florida (1980)

26. During 1971, ABC obtained 43,347 shares of NBC common stock when NBC declared a stock dividend, increasing the aggregate number of shares of NBC's common stock held by ABC to 476,819 at December 31, 1971.

27. During 1972, ABC obtained 19,072 shares of NBC common stock when NBC declared a stock dividend, and acquired 95,363 shares of NBC common stock in a capital call for aggregate consideration of $2,407,915 ($25.25 per share). This capital call was made to address the concerns of federal bank regulators that NBC was inadequately capitalized. On November 11, 1972, ABC acquired 6,165 shares of NBC stock from John Grey, for $616,500. At December 31, 1972, ABC held 597,419 shares of the outstanding common stock of NBC, 60.18 percent of the stock outstanding on that date.

28. During 1973:

(a) ABC obtained 23,902 shares of NBC common stock when NBC declared a stock dividend; acquired 103,887 shares of the common stock of NBC in a capital call in October, 1973 for aggregate consideration of $2,077,740 ($20 per share); acquired 135 shares of NBC common stock from John Grey for $13,500 and acquired $3,116,610 of NBC's 8% Capital Convertible Debentures in a capital call. At issuance,

the debentures were convertible into NBC common stock at $30 per share. No debentures had been converted by December 31, 1973, at which date ABC owned 700,343 shares of the common stock of NBC (see paragraph 28(b), below, with respect to sale by ABC of 25,000 shares), 59.95 percent of the NBC common stock then outstanding;

(b) ABC sold 25,000 shares of the NBC stock ABC had acquired in the October, 1973 capital call to John W. Hazard for $493,750 ($19.75 per share). The difference between the price of the stock to ABC and the price to Mr. Hazard reflected a $0.25 cash dividend per share paid ABC before the stock was sold to Mr. Hazard.

(c) NBC recognized loan losses of $12,778,821 (net of recoveries) and increased its loan reserves $572,912 from $982,072 to $1,554,984. NBC had a net loss for the year of $10,201,381. Attached hereto as Exhibit 58 is a copy of the 1973 NBC Annual Report.

29. During 1974:

(a) NBC reduced from $30 to $25 per share the conversion price of its capital convertible debentures and ABC converted its $3,116,610 in debentures to 124,664 shares of NBC's common stock; ABC acquired 2,402 shares of NBC common stock for $61,946 from Universal Insurance Company, a corporation subsequently acquired by ABC as a consolidated subsidiary; and ABC reacquired from John W. Hazard the 25,000 shares sold to Mr. Hazard in 1973 for $493,750 (the cost of the shares to Mr. Hazard). At December 31, 1974, ABC owned 852,409 shares of the common stock of NBC, representing 65.77 percent of NBC's then outstanding common stock.

(b) NBC experienced loan losses of $2,621,628 (net of recoveries) and increased its loan loss reserve $2,195,016

from $1,554,984 to $3,750,000 (excluding an additional $1,800,000 received from ABC in February, 1975 as consideration for $5,000,000 in previously charged-off notes). NBC had a net loss for the year of $4,627,012.

(c) Attached hereto as Exhibit 59 is the 1974 NBC Annual Report.

30. During 1975:

(a) NBC sold ABC $5,000,000 in previously charged-off loans in February, 1975 for $1,800,000 on terms that assured that NBC would realize the benefit of any recovery in excess of ABC's cost and expenses. The amount received by NBC was added to its loss reserve.

(b) On June 30, 1975, ABC sold 661,000 shares of NBC common stock to a group of 63 Texas investors. In exchange for this stock, which constituted 51 percent of the then outstanding stock of NBC, ABC received (i) $1,059,914 in cash, and (ii) a note ("Note") face amount $6,006,176, secured by the 661,000 shares of stock. The parties have agreed that the fair market value of the Note on June 30, 1975 was $4,878,088. Attached are copies of the following documents with respect to this sale: Definitive Stock Purchase Agreement and Grant of Security Interest (Exhibit 32); Note (Exhibit 33); Pledge and Security Agreement (Exhibit 34); Voting Trust (Exhibit 35); and list of investors (Exhibit 36). The net asset value per share of NBC as reflected in NBC's June 30, 1975 statement of condition, attached hereto as Exhibit 60, was $10.69 per share.

(c) The net asset value per share of NBC as reflected in NBC's December 31, 1975 statement of condition, attached hereto as Exhibit 61, was $2.30 per share.

31. As a result of the loans classified as uncollectible or doubtful during the examination conducted in July and August

of 1975 the Comptroller required NBC to increase its capital by a minimum of $8,000,000. Attached are copies of: a letter dated December 4, 1975, from ABC to Edward C. Nash, Jr., Fred T. Brooks and H. D. Stanley, Trustees for the investors (Exhibit 37); Mr. Nash's December 5, 1975 telegram (Exhibit 38); a telegram dated December 8, 1975 by ABC to Mr. Nash, et al. (Exhibit 39); a letter dated December 9, 1975, to ABC from Carl E. Oates, counsel for the Trustees representing the investors (Exhibit 40); a telegram dated December 9, 1975 from Carl E. Oates, as counsel for the Trustees, to ABC (Exhibit 62); and ABC's letter dated December 10, 1975, to Carl E. Oates (Exhibit 41).

32. On January 21, 1976, ABC made a book entry writing down the value of the Note by $4,485,876. A copy of the ledger sheets reflecting this entry is attached as Exhibit 63. The charge-off against the value of the Note was also reflected in ABC's 1975 annual report. A copy of ABC's 1975 Annual Report (with references to the charge-off appearing at pages 15, 18 and 19) is attached hereto as Exhibit 64.

33. A claim for a deduction arising from the partial worthlessness of the Note was set forth in ABC's Protest dated June 9, 1978. A copy of that Protest is attached hereto as Exhibit 65.

34. In April, 1976, ABC sold the Note acquired on June 30, 1975, to Mr. Coke L. Gage for $1,652,500. As a condition of this sale, ABC acquired an additional 573,953 shares of NBC's common stock in a capital call for $1,233,999. In connection with the sale of the Note, ABC incurred sales expenses of $33,050 and legal fees of $5,050. The following are copies of the principal documents setting forth the agreement between ABC and Mr. Gage:

(a) Memorandum of Agreement dated February 9, 1976, between ABC and Mr. Gage (Exhibit 42);

(b) Assignment dated April 7, 1976, between ABC and Mr. Gage (Exhibit 43);

(c) Memorandum dated April 8, 1976, from S. Walton Maurras to David Stubblefield (Exhibit 44);

(d) Letter dated April 7, 1976, from James C. Travis of NBC to ABC, Mr. Gage and William R. Riley (Exhibit 45);

(e) Endorsement to the June 30, 1975, note, dated April 7, 1976, from ABC to Mr. Gage (Exhibit 46);

(f) Release executed by Fred T. Brooks and Edward C. Nash, Jr. on April 7, 1976, releasing ABC from obligations set forth in Article VII of the Definitive Stock Purchase Agreement and Grant of Security Interest dated June 30, 1975 (Exhibit 47);

(g) Acknowledgment dated April 7, 1976, from Mr. Gage to ABC notifying ABC of the satisfaction of the conditions set forth in paragraphs 2(a) and (b) of the February 9, 1976, memorandum agreement (Exhibit 48);

(h) Acknowledgement dated April 7, 1976, from Coke L. Gage reflecting receipt of the original executed instrument entitled Voting Trust Agreement (Exhibit 49);

(i) Receipt for stock certificate dated April 7, 1976, executed by Mr. Gage (Exhibit 50);

(j) Release dated April 7, 1976, executed by Edward Nash, Jr. on behalf of NBC releasing ABC from all obligations pursuant to a June 30, 1975, commitment letter from ABC to NBC (relating to subordinated capital debentures, notes and other securities of NBC) (Exhibit 51);

(k) Subscription Agreement dated April 7, 1976, pursuant to which Mr. Gage unconditionally subscribed to

purchase 486,750 shares of the common stock of NBC (Exhibit 52);

(l) Undated Resolution releasing ABC from its commitments concerning subordinated debentures (Exhibit 53);

(m) Letter dated April 1, 1976, from James S. Robertson, Jr., Esq., attorney for Mr. Gage, advising ABC, through its attorney, Thomas Harper, Esq., of the satisfaction of the conditions contained in paragraph 2(b) of the Memorandum of Agreement dated February 9, 1976, (Exhibit 54);

(n) April 21, 1976, proxy statement of ABC (Exhibit 55).

35. Concurrently with the sale to Mr. Gage, ABC granted William R. Riley of Dallas, Texas an option to purchase its remaining 765,362 shares of NBC common stock in annual installments through 1980 at a price of $2.20 per share. William R. Riley or his assignees under an assignment made on August 16, 1978, exercised these option rights as follows:

(a) On December 15, 1976, Mr. Riley acquired 15,000 shares of NBC common stock, so that ABC held 750,362 shares at NBC common stock at December 31, 1976.

(b) On December 25, 1977, Mr. Riley acquired 50,000 shares of the NBC common stock, so that ABC held 700,362 shares of NBC common stock at December 31, 1977.

(c) On December 15, 1978, Mr. Riley or his assignees acquired 215,226 shares of NBC common stock, so that ABC held 485,136 shares of NBC common stock at December 31, 1978.

(d) On June 15, 1979, Mr. Riley or his assignees acquired 215,226 shares of NBC common stock.

(e) On December 15, 1980, Mr. Riley or his assignees acquired 269,910 shares of NBC common stock. Thereafter, ABC owned no shares of NBC common stock, or any other

stock or security interest in NBC. A copy of the Option Agreement is attached as Exhibit 56.

36. ABC received the following dividends and interest payments from NBC with respect to stock and securities owned in NBC:

Year	Dividends	Interest on Debentures	Total
1968	$ 43,292	None	$ 43,292
1969	207,024	None	207,024
1970	325,104	None	325,104
1971	357,614	None	357,614
1972	534,037	None	534,037
1973	635,409	$ 92,806	728,215
1974	None	103,887	103,887
1975	None	None	None
1976	None	None	None
Total	$2,102,480	$196,693	$2,299,173

37. Expressed as a percentage return on capital invested, the dividends and interest paid to ABC with respect to its stock and security interests in NBC were:

Year	Average Capital Account*	Dividends and Interest	Return on Capital
1968	$ 3,886,562	$ 43,292	1.11%
1969	9,954,721	207,024	2.08%
1970	12,136,318	325,104	2.68%
1971	12,136,318	357,614	2.95%
1972	13,648,526	534,037	3.91%
1973	17,517,783	728,215	4.16%
1974	20,152,681	103,887	0.52%
1975	16,897,484	None	0.00%
1976	13,347,939	None	0.00%

* One-half of the sum of the beginning-of-year and end-of-year capital account.

38. ABC experienced the following cash flow with respect to its stock and security interests in NBC:

Year	Dividends and Interest	Principal Capital Infused*	Paid On Initial Acquisition Indebtedness and Interest Paid on All Acquisition Indebtedness	Cumulative Cash Flow Through Year Specified
1968	$ 43,292	$ (86,128)	$(7,042,705)	$ (7,085,541)
1969	207,024	(4,363,194)	(439,262)	(11,680,973)
1970	325,104	-0-	-0-	(11,355,869)
1971	357,614	-0-	(219,841)	(11,218,096)
1972	534,037	(3,024,415)	(142,565)	(13,851,039)
1973	728,215	(1,597,490)	(38,550)	(14,758,864)
1974	103,887	(3,672,296)	(2,935)	(18,330,208)
1975	None	-0-	(37,955)	(18,368,163)
1976	None	(1,233,999)	-0-	(19,602,162)

* Excluding initial acquisition indebtedness.

39. To assist in the sale of its stock in NBC, on or about August 20, 1974, ABC retained the services of Goldman, Sachs & Co. Attached as Exhibit 57 is a copy of a letter from Goldman, Sachs & Co. to Mr. H. L. Hembree dated August 20, 1974.

40. By letter dated April 22, 1981, respondent requested, pursuant to Rule 70(a)(1) of the Tax Court's Rules of Practice and Procedure, that the petitioner respond to certain informal discovery. Attached as Exhibit J is a copy of said letter and attachment (informal discovery requests).

41. On or about August 27, 1981, petitioner's counsel furnished respondent petitioner's responses to respondent's informal discovery. Attached as Exhibit K is the response and attached exhibits.

42. By letter dated October 13, 1981, respondent served formal discovery on petitioner's counsel. Attached as Exhibit L are copies of said letter and attachments.

43. Attached as Exhibit M are petitioner's responses to respondent's formal discovery requests.

44. By letter dated October 28, 1981, respondent served upon petitioner's counsel "Second Interrogatories" and a "Request For Production of Documents". Attached as Exhibit N is a copy of said letter with attachments.

45. On or about January 22, 1982, petitioner's counsel responded to respondent's second formal discovery request. Attached as Exhibit O are copies of petitioner's responses.

46. Respondent requested that petitioner furnish respondent complete copies of all minutes of the meetings of the Board of Directors and Executive Committee of Arkansas Best Corporation at which the National Bank of Commerce was discussed. Attached as Exhibit P are petitioner's counsel's responses to said request.

47. On or about February 15, 1983, petitioner served upon respondent's counsel "Interrogatories". Attached hereto as Exhibit 66 is a copy of respondent's response.

48. The parties have settled the following issues as stated:

ARKANSAS BANDAG CORP.

Item	Statutory Notice	Years	Amount of Adjustment
(a)	Page 21,	1973	$ 6,028
	Schedule 1-B	1974	75,619
		1976	221,281

The Petitioner's tax liability for the years 1973, 1974, 1975 and 1976 will be computed (a) by permitting Petitioner to depreciate truck terminals and tire processing structures to its subsidiary, ABC Treadco, Inc. (formerly Arkansas Bandag Corporation) on which the Commissioner proposed useful lives of twenty-two years or greater over a twenty-two year useful life with no salvage value, and (b) by otherwise computing petitioner's depreciation deductions as proposed by the Commissioner, with the depreciation deductions claimed for those years being reduced $4,492, $49,493, $116,754, and $109,827, respectively.

All adjustments set forth in the statutory notice of deficiency have been conceded by petitioners' counsel to be correct except those set forth in paragraphs 4 and 48 of this Stipulation.

KENNETH W. GIDEON
Chief Counsel
Internal Revenue Service

(Signed)
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UNITED STATES TAX COURT

ARKANSAS BEST CORPORATION AND SUBSIDIARIES, *Petitioner,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	Docket No. 18954-80

DECISION

Pursuant to the opinion of the court filed October 29, 1984, and incorporating herein the facts recited in petitioner's computation as the findings of the Court, it is

ORDERED and DECIDED: That there are deficiencies in income taxes and additions to the tax due from the petitioner as follows:

Taxable Year	Deficiencies
1969	$ 20 224.00
1970	20,224.00
1971	50,560.00
1972	2,495,451.00
1973	483,157.00
1974	217,498.00
1975	6,829.00
1976	188,790.00

(Signed)
ARTHUR L. NIMS, III
Judge

Entered: March 5, 1985

• • • •

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the court and the petitioner's computation, and that the court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

(Signed)
Vester T. Hughes, Jr.

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Dated: 2-13-85

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

JUDGMENT

Nos. 85-1702/1818

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,

Appellee, Cross-appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Appellant/Cross-appellee.

Appeals from the United States Tax Court

These appeals from the United States Tax Court were submitted on the record of the Tax Court, briefs of the parties and were argued by counsel.

After consideration it is ordered and adjudged that the judgment of the Tax Court be affirmed in part and reversed in part consistent with the opinion of this Court.

September 9, 1986

Order entered in
accordance with opinion
(Signed) Robert D. St. Vrain
Clerk, U.S. Court of Appeals,
Eighth Circuit

Supreme Court of the United States

No. 86-751

ARKANSAS BEST CORPORATION,

Petitioner

v.

COMMISSIONER OF THE INTERNAL REVENUE

ORDER ALLOWING CERTIORARI. Filed March 23, 1987.

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted.

PETITIONER'S

BRIEF

Supreme Court, U.S.
FILED
MAY 6 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-751

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to
the United States Court of Appeals
for the Eighth Circuit

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

Shall corporate stock, futures contracts, and other securities held for business purposes continue to be treated as non-capital assets, as held by this Court in *Corn Products* and a host of other courts thereafter, or should *"Corn Products* and its progeny," regarded by the Eighth Circuit as "misbegotten," now be overruled?

LIST OF PARTIES

The petitioner is Arkansas Best Corporation and Subsidiaries. All of Arkansas Best Corporation's subsidiaries are wholly owned.

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No. 86-751

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to
the United States Court of Appeals
for the Eighth Circuit

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit (Pet. App.* A-1 — A-12), including the dissenting opinion of Judge Hanson, is reported at 800 F.2d 215 (8th Cir. 1986). The opinion of the United States Tax Court (Pet. App. B-1 — B-28) is reported at 83 T.C. 640 (1984).

* Pet. App. refers to the Appendix to the Petition for Writ of Certiorari herein.

STATEMENT OF JURISDICTION

The judgment of the court of appeals below was entered on September 9, 1986. The petition for writ of certiorari was granted by this Court on March 23, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) (1966).

STATUTORY PROVISION INVOLVED

26 U.S.C. §1221:[1]

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include —

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for the sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by —

(A) a taxpayer whose personal efforts created such property,

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[1] Unless otherwise noted, Section references are to the Internal Revenue Code of 1954, as amended, except for references to "Section 117," which is a reference to the Internal Revenue Code of 1939, as amended.

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public and which is held by —

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).

STATEMENT OF THE CASE

Arkansas Best Corporation (hereinafter "Arkansas Best") is a diversified holding company based in Fort Smith, Arkansas. In 1968, it owned subsidiaries engaged in trucking, furniture manufacturing, data processing and other businesses. Because its earnings from these operations were highly cyclical, Arkansas Best decided to acquire businesses which could

provide a more stable pattern of earnings over time. One industry which Arkansas Best identified as having this general characteristic was the banking or financial services industry.

In pursuit of this objective, Arkansas Best in 1968 purchased sixty-five percent of the stock of National Bank of Commerce (hereinafter referred to as the "Bank"), then the fourth largest bank in Dallas, Texas. In 1970, however, new Congressional legislation effectively frustrated Arkansas Best's purpose. The Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, Title I, §103, 84 Stat. 1760 (1970) (hereinafter referred to as the "Amendments") prohibited a "one-bank" bank holding company from acquiring new businesses unrelated to banking. Thus, the Amendments would effectively prohibit Arkansas Best — as a "one-bank" bank holding company — from expanding its nonbank businesses, such as trucking or furniture manufacturing, through acquisitions.

The Amendments permitted a company which was unwilling to live with such restrictions to free itself of those restrictions by making a binding commitment to divest its interest in the bank. Such a company was required to file with the Board of Governors of the Federal Reserve System an irrevocable notice of intention to divest its interest in the bank. Arkansas Best filed such a notice on August 1, 1971, and promptly commenced efforts to sell its stock in the Bank.

Public awareness of Arkansas Best's need to sell its Bank stock made it difficult for Arkansas Best to dispose of that stock. Its efforts were made more difficult by increasingly serious financial problems at the Bank. Beginning in 1971, the Office of the Regional Administrator of National Banks made a series of determinations that additional capital had to be raised by the Bank. Despite the fact that on August 1, 1971 the board of directors of Arkansas Best had passed a resolution stating that the company would purchase additional Bank

stock only when absolutely necessary, the deterioration of the financial condition of the Bank forced Arkansas Best to make just such stock purchases from the Bank to provide the additional capital demanded by the regulatory authorities.

Thus, after it filed its notice of intention to divest itself of its Bank stock on August 1, 1971, Arkansas Best made a number of additional purchases of Bank stock ("post-1971 acquisitions"). It did so in an effort to prevent the imposition of sanctions — including a possible closing of the Bank — by the regulatory authorities.[2] Such sanctions would have severely damaged Arkansas Best's reputation as a responsible, competently managed, diversified holding company, as well as its banking and financial relationships.

As to all of these post-1971 acquisitions of Bank stock, Arkansas Best suffered undisputed losses when it finally was able to sell its interest in the Bank beginning in 1975. Arkansas Best sought to deduct these losses from its income as ordinary losses.[3] The Commissioner of Internal Revenue disallowed such deductions, characterizing them as capital losses. Such capital

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[2] Two small acquisitions of stock were made for other reasons, one in connection with an employment dispute, which the Tax Court found to be business motivated, 83 T.C. at 657; Pet. App. at B-21, and another in connection with insurance regulatory requirements. *See* discussion at fn. 4, *infra* at p. 7.

[3] Arkansas Best also sought to deduct as an ordinary item the losses incurred on sales of Bank stock acquired in 1968 and 1969. The Tax Court held that losses on sales of all Bank stock acquired prior to 1973 were capital losses. 83 T.C. at 655; Pet. App. at B-19. Arkansas Best appealed the decision of the Tax Court to the Eighth Circuit Court of Appeals only with respect to the proper characterization of the losses incurred on the sales of the post-1971 acquisitions. Accordingly, the character of the losses incurred on the Bank stock acquired in 1968 and 1969 is no longer an issue in this case.

losses are not deductible against the ordinary income of a corporation, but may be used only to offset capital gains.

Arkansas Best challenged the Commissioner's deficiency determination in the United States Tax Court, which had jurisdiction over the action under Section 6213 (26 U.S.C. §6213). After a full trial, Judge Nims of the Tax Court found as a threshold matter that Arkansas Best, as a holding company, was engaged in the "trade or business defined as the acquisition and management of going concerns in diverse yet complementary lines of business." 83 T.C. at 653; Pet. App. at B-16. Judge Nims went on to make findings of fact regarding Arkansas Best's purposes in making its post-1971 acquisitions of Bank stock. With respect to the stock acquired by Arkansas Best prior to 1973, the Tax Court found that such purchases "were motivated primarily by investment purposes and only incidentally by some business purpose." 83 T.C. at 654; Pet. App. at B-18. Based upon this Court's decision in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), and its own decision in *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977), the Tax Court held that Arkansas Best's losses on the sale of such stock were capital losses. 83 T.C. at 655; Pet. App. at B-19.

As to Bank stock acquired after 1972, the Tax Court found that "[t]hese later purchases were made exclusively for business purposes and subsequently held for the same reasons." 83 T.C. at 656; Pet. App. at B-20. In particular, the Court held:

> Expenditures to preserve business reputation are typically currently deductible business expenses . . . . The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products*.
>
> • • •

> [Arkansas Best] carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

83 T.C. at 656-57; Pet. App. at B-20-21.

Arkansas Best appealed from the Tax Court's finding as to the purpose of the 1972 purchases of Bank stock.[4] Arkansas Best argued that these purchases, like those made after 1972, were motivated by business purposes, and not by investment purposes. Among other things, Arkansas Best pointed out the undisputed evidence that it irrevocably had committed itself to sell all of its Bank stock in 1971, and was engaged actively in efforts to accomplish such a divestiture throughout 1972. Its purchases of stock in response to capital calls in 1972 therefore were not part of any effort to invest in such stock in order to realize a profit, but were made to protect its business reputation by maintaining the solvency of the Bank.

The Commissioner, however, appealed from the Tax Court's holding that the losses resulting from the sales of Bank stock purchased after 1972 were ordinary losses. The Commissioner

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[4] Arkansas Best also appealed the decision of the Tax Court that it was not entitled to an ordinary loss in connection with the sale of the Bank stock acquired by Arkansas Best from its subsidiary, Universal Insurance Company ("Universal"). The Tax Court based its decision on an erroneous reading of a stipulation. 83 T.C. at 657; Pet. App. at B-21. The Government has conceded that the Tax Court's interpretation of the stipulation was incorrect, but nevertheless continues to claim that such stock was a capital asset. Brief for Appellant and Cross-Appellee at 9, fn. 8, *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 800 F.2d 215 (8th Cir. 1986) (Nos. 85-1702, 85-1818).

did not directly challenge the Tax Court's factual findings that the post-1972 stock purchases were made solely for business purposes and with no investment purpose whatsoever. He argued instead that "[t]he findings of fact of the Tax Court demonstrate that the [Bank] stock was never integral to the 'complementary group' of businesses carried on by the taxpayer and its subsidiaries." Brief for the Appellant and Cross-Appellee at 12, *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 800 F.2d 215 (8th Cir. 1986) (Nos. 85-1702, 85-1818). The Commissioner contended that the losses resulting from purchases of Bank stock could be treated as ordinary losses only if such stock was "integral" to the business of Arkansas Best.

The Eighth Circuit Court of Appeals, on September 9, 1986, held that all of the losses suffered by Arkansas Best as a result of sales of the Bank stock were capital losses, and hence nondeductible against ordinary income. 800 F.2d 215 (8th Cir. 1986). Speaking for a divided court, Judge Bowman concluded that corporate stock does not fall within the language of any exclusion from the statutory definition of "capital asset." Accordingly, the court of appeals held that corporate stock not held by a securities dealer always is a capital asset, regardless of the purposes for its acquisition or retention or any surrounding factual circumstances. Under this holding, the Tax Court's findings as to Arkansas Best's purposes in acquiring the Bank stock were irrelevant, even though unchallenged.

The majority opinion expressly and necessarily rejected contrary holdings of the Courts of Appeals for the Fourth and Fifth Circuits, the Tax Court, and the Court of Claims.[5] Each

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[5] *Wright v. Commissioner*, 756 F.2d 1039 (4th Cir. 1985); *Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984); *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S.

of these cases, and similar decisions of the Courts of Appeals for the Sixth and Seventh Circuits,[6] had applied this Court's decision in *Corn Products* to hold that transactions in corporate stock could give rise to ordinary gain or loss under certain circumstances. In criticizing these decisions, the majority opinion of the court of appeals below referred to "*Corn Products* and its progeny, which we respectfully view as misbegotten." 800 F.2d at 221; Pet. App. at A-10. It stated:

> We do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221.

Id.

The court of appeals offered two brief reasons for its holding. Most significant to the court was its conclusion that corporate stock is not within the language of any statutory exclusion to the definition of "capital asset," regardless of the taxpayer's motives for acquiring and holding that stock. 800 F.2d at 220; Pet. App. at A-9. The majority opinion argued that Congress might have written such an explicit exception regarding corporate stock, but had not, and asserted that "the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make." *Id.* The Eighth Circuit further argued that *Corn Products* and its progeny had fostered "subjectivity and uncertainty" in the tax code, "leading to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' intentions in purchasing capital stock." *Id.*

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966 (1977); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962).

[6] *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970); *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964).

In a dissenting opinion, Judge Hanson expressed his view that the losses suffered by Arkansas Best on stock acquired after 1972 were ordinary losses. After noting that "*Corn Products* was merely an attempt to divine congressional intent," 800 F.2d at 221; Pet. App. at A-11, Judge Hanson stated:

> [C]onsistent with *Corn Products*, the stock was purchased as an integral and necessary act in the conduct of Arkansas Best's business as a holding company.

Id. at 222; Pet. App. at A-11-12.

Arkansas Best thereafter filed its petition for writ of certiorari, pointing out the lack of precedent for the decision of the court of appeals, the conflicts among the circuits, the Tax Court, and the Court of Claims created by the decision of the court of appeals below, and the continuing importance of the issues presented.[7] The Commissioner concurred in the petition. This Court granted the petition for writ of certiorari on March 23, 1987.

SUMMARY OF THE ARGUMENT

The decision of the Eighth Circuit Court of Appeals in this case is fundamentally inconsistent with *Corn Products Refining*

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[7] As both Arkansas Best and the Government have noted, the capital/ordinary distinction will have continued significance for the taxation of both gains and losses throughout the Internal Revenue Code, despite the fact that under the changes effected by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 301, 311, 100 Stat. 2085 (1986), ordinary income will be subject to the same maximum rate of tax as capital gains. Arkansas Best Petition for Writ of Certiorari at 20-21, *Arkansas Best Corporation and Subsidiaries v. Commissioner of Internal Revenue* (No. 86-751); Brief on Petition for Writ of Certiorari for Commissioner of Internal Revenue at 14, *Arkansas Best Corporation and Subsidiaries v. Commissioner of Internal Revenue* (No. 86-751).

Company v. Commissioner, 350 U.S. 46 (1955). In *Corn Products*, this Court rejected a literal application of the statute defining "capital asset" in favor of a standard intended to distinguish between assets acquired and held in connection with the taxpayer's usual trade or business and those acquired principally for investment. Such a standard far more correctly reflects the purpose of Congress in this important area of the tax law, and prevents the absurd and unintended results that otherwise would obtain. Accordingly, an evaluation of the taxpayer's motives and business circumstances is essential under *Corn Products*, and an asset cannot be classified as "capital" without regard to the factual circumstances of the particular case under consideration.

In this case, the Eighth Circuit refused to apply the principles of *Corn Products*, suggesting that the sole permissible inquiry was whether corporate stock falls within the language of any specific exclusion to the statutory definition of "capital asset." The majority opinion of the court of appeals eschewed any consideration of the facts surrounding the acquisition by Arkansas Best of the Bank stock at issue, holding in essence that corporate stock is always a capital asset (unless held by a securities dealer), regardless of the reasons for which it is acquired by a taxpayer. Because the Eighth Circuit's ruling cannot be reconciled with this Court's controlling decision in *Corn Products*, the ruling of the court of appeals must be reversed.

This conclusion is reinforced by an examination of the many cases applying the *Corn Products* doctrine over the last thirty years. Prior to the decision of the Eighth Circuit in this case, the courts unanimously had held that the tax consequences in such cases were not dictated by the kind of asset, but by the purposes of the individual taxpayer for acquiring and holding the asset. Corporate stock therefore was held in numerous

cases to constitute an "ordinary" asset, even though that result could not have been reached based on the statutory language alone. The law, as set forth in *Corn Products* and the many cases applying it since 1955, clearly requires the same result in this case, based on the unchallenged factual findings of the Tax Court.

The majority opinion below not only is unfaithful to *Corn Products* and contrary to all subsequent judicial authority, but is based upon faulty judicial reasoning. A court best carries out its duty in interpreting a statute by determining and effectuating the intent of Congress, and not by a mere mechanical reading of the words of the statute. Here, this conclusion is fortified by extensive evidence that Congress is aware of and approves the *Corn Products* doctrine, and by the illogical and unintended results that necessarily would flow from a literalistic reading of the statute.

The extensive judicial authority applying the doctrine, and the rejection by Congress of legislation that would have changed it or added administrative requirements for its invocation, likewise refute the only other rationale offered by the Eighth Circuit for its unprecedented decision. Contrary to the suggestion of the majority opinion, the *Corn Products* doctrine has proved workable, and has not created unmanageable demands on administrative or judicial processes. An examination of the subjective motivations of taxpayers is a familiar and inevitable part of applying Section 1221, as well as many other tax provisions, and certainly provides no justification for jettisoning *Corn Products* and thirty years of subsequent authority.

The proper standard for determining whether corporate stock is a capital asset is the "dominant business motive" test. Under this test, stock will not be regarded as a capital asset if the dominant or primary motive for acquiring the stock is

related to the taxpayer's business, rather than to earn an investment profit. The adoption of this standard is counselled by this Court's past decisions and will prove superior in practice to the alternative "absence of substantial investment motive" test. Under the correct standard, Arkansas Best is entitled to ordinary loss treatment with respect to its losses on sales of Bank stock acquired after 1971.

ARGUMENT

I. THE DECISION OF THE EIGHTH CIRCUIT IS IRRECONCILABLE WITH *CORN PRODUCTS*, IN WHICH THIS COURT REJECTED A LITERAL APPLICATION OF THE STATUTORY DEFINITION OF "CAPITAL ASSET"

Over thirty years ago, this Court unanimously held in *Corn Products* that corn futures contracts acquired as an integral part of the taxpayer's everyday business operations constituted non-capital assets. The Court so held without regard to the fact that identical futures contracts held by an *investor* undoubtedly would have been capital assets. Moreover, that conclusion was reached despite the Court's express acknowledgement that its decision could not be justified by the literal language of the statutory provision defining "capital asset."[8] In effect, this Court recognized that a proper application of the capital asset definition as understood by Congress requires an analysis which reaches beyond the literal terms of the statute, and instead focuses on the circumstances surrounding the use to which the property is to be put by the taxpayer.

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[8] The relevant statutory language set forth in Section 117 of the Internal Revenue Code of 1939, Pub. L. No. 76-155, 53 Stat. 862 (1939), and considered by this Court in *Corn Products* is virtually identical to the language now contained in Section 1221(1) and (2).

The factual circumstances and legal arguments presented to this Court in *Corn Products* confirm the need to go beyond a literal interpretation of Section 1221 in order to effect the intent of Congress. Corn Products Refining Company (hereinafter referred to as the "Company") was engaged in the business of manufacturing various products from corn, such as starch and sugar. The Company was unable to maintain substantial supplies of corn on hand due to its limited storage capacity. In order to avoid a price squeeze if it were required to purchase corn on the open market at prices in excess of that which it had assumed in setting fixed prices for future deliveries, the Company purchased corn futures contracts. The Company would take delivery on these contracts when necessary to maintain an adequate supply of corn at a predetermined price. As a result, if a corn shortage occurred, it would be protected against a price increase. If no shortage occurred, the contracts were sold. The issue considered by the lower courts and presented to this Court for review was whether gains on the sales of the futures contracts in this factual context were capital gains or ordinary income. This Court concluded that because the profits from the sales of the futures contracts were related to the everyday business operations of the Company, they were required to be treated as ordinary income. 350 U.S. at 52.

An examination of the arguments made by the taxpayer and the Government in *Corn Products* demonstrates that this Court's opinion represented a deliberate decision to look beyond the literal language of the statutory exceptions set forth in Section 117 (the predecessor to Section 1221) to the policy of the statute. In reaching that conclusion, this Court considered, and rejected, the arguments of the Company that corn futures contracts were required to be treated as capital assets simply because they did not fall within any of the statutory exceptions under Section 117. *See* Brief for Corn Products at

11, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) [hereinafter cited as "Brief for Corn Products"]. According to the Company, the exclusions under Section 117 were comprehensive; it felt that Congress, in setting forth these exceptions had addressed itself "specifically, . . . unambiguously, and . . . comprehensively" to the problem of defining a capital asset. Brief for Corn Products at 15. The Company argued: "Where a statute sets up a general rule and enumerates specific exceptions, as a matter of statutory construction further exceptions by way of *mere implication* are not permissible." Reply Brief for Corn Products at 4, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) [hereinafter cited as "Reply Brief for Corn Products"]. Moreover, the Company warned that the test applied by the Tax Court in that case — whether futures contracts were an integral part of the taxpayer's manufacturing business — not only ignored the literal language of Section 117, but was an amorphous standard that was nothing less than the rankest sort of judicial legislation. Brief for Corn Products at 32, 33. Only "great uncertainty in the administration and application of the capital limitations" would result from a focus on the purpose or intent of the taxpayer rather than the statutory language. Reply Brief for Corn Products at 28.

The arguments of the Company in favor of a literal interpretation of the statute were countered by equally emphatic arguments to the contrary by the Government. The Government argued that the exceptions under Section 117 simply were evidence of the intent of Congress that profits or losses from everyday business activities are not to be accorded the special treatment reserved for capital assets.

> [W]e disagree with the conclusion that taxpayer draws, namely, that since the futures contracts do not come within the precise words of the enumerated exceptions, they must be classified as capital assets.

Brief for United States at 19, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20) [hereinafter cited as "*Corn Products* Brief for United States"].

Instead, the Government argued that the purpose of the transaction should be determinative of whether the asset should be classified as a capital asset. *Id.* at 13, 31. The Government concluded that since the purpose of the purchase of the corn futures contracts was to provide price protection and to ensure an adequate supply of corn in excess of the Company's limited storage capacity, both of which were related to taxpayer's ordinary business activities, the gains resulting from the transactions in the corn futures contracts should be treated as ordinary income. As summarized by the Government in its brief, "It is therefore essential to examine the nature of taxpayer's transactions in commodities futures in the context of the over-all operations of its manufacturing business." *Id.* at 31.

The unanimous opinion of this Court made it clear that its conclusion was compelled not by any mechanical application of the statutory language, but by its firm understanding of the purpose of Congress in enacting the statute.

> Admittedly, petitioner's corn futures do not come within the literal language of the exclusions of [Section 117] .... But the capital-asset provisions of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. Burnet v. Harmel, 287 U.S. 103, 108, 53 S.Ct. 74, 76, 77 L.Ed. 199. Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than

> capital gain or loss. The preferential treatment provided by §117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." Burnet v. Harmel, 287 U.S. at page 106, 53 S.Ct. at page 75. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose.

350 U.S. at 51-52.

Thus, this Court chose to view the categories of exclusions as indicia of the type of property that Congress intended to exclude.[9] The common thread which the Court saw running

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[9] The conclusion that the exceptions set forth in Section 1221 are merely examples of the type of assets which are excluded from the definition of capital asset is confirmed by the Internal Revenue Code. Like its predecessor Section 117, Section 1221 only defines "capital asset" by enumerating assets that are not capital assets. Section 7701(c) provides that:

> "includes" and "including" when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined.

This instruction has been contained in the Code in substantially the same form since 1924. *See* Section 2(b) of the Revenue Act of 1924, Pub. L. No. 68-176, 43 Stat. 253 (1924). Thus, in Section 1221, which effectively defines the term "noncapital asset," the five exceptions are clearly not meant to be an exhaustive list. If Congress had intended for this list to be exclusive, it would have used a word such as "except," rather than "include." As this Court previously has noted "use of the word 'include' . . . suggests a calculated indefiniteness with respect to the outer limits of the

through those exclusions was that they distinguish between transactions which arise from "everyday operations of a business" and those which arise from the activities of a "legitimate capitalist." 350 U.S. at 49, 52. *See* Note, "The Troubled Distinction Between Capital Gain and Ordinary Income," 73 *Yale L. J.* 693 (1964). Because the business purposes of the taxpayer in *Corn Products* were such that its corn futures profits were akin to "profits arising from the everyday operation of a business," the Court held them to be ordinary gains taxable at a much higher rate than that applicable to capital gains.

While this Court's decision has been criticized by some commentators for looking beyond the specific statutory exclusions to the capital asset definition,[10] the decision was plainly appropriate given the unintended breadth of the definition of capital asset as set forth in Section 117.[11] *Corn Products* and its progeny represent those courts' recognition of

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term [defined]." *First National Bank in Plant City, Florida v. Dickinson*, 396 U.S. 122, 135 (1969). This Congressionally mandated rule of construction confirms the validity of this Court's decision to look beyond the statutory exclusions of Section 117 to that section's intended purpose.

[10] *See, e.g.*, Freeman, "Is There a New Concept of Business Asset?", 36 *Taxes* 110 (1958); Kauffman, "A Second Look at the *Corn Products* Doctrine," 41 *Taxes* 605 (1963); Brown, "The Growing 'Common Law' of Taxation," 34 *S. Cal. L. Rev.* 235 (1961); Note, "Judicial Treatment of 'Capital' Assets Acquired for Business: The New Criterion," 65 *Yale L. J.* 401 (1956).

[11] This Court has approached in numerous ways the issues presented by the broad approach adopted by Congress in defining a "capital asset" in Section 1221. As the Court of Claims noted in citing a passage from Eustice, "Contract Rights, Capital Gain, and Assignment of Income — the *Ferrer* Case," 20 *Tax L. Rev.* 1 (1964), in *Norton v. United States*, 551 F.2d 821, 826 fn. 17 (Ct. Cl.), *cert. denied*, 434 U.S. 831 (1977):

> the failure of Congress to face up realistically to the classification problem inherent in the attempted division between "investment" and "business."... [T]herefore [Congress] did not desire to be taken literally when it used the broad term "property" in section 1221. The courts are willing to rescue Congress from its statutory strait jacket.

Surrey, "Definitional Problems in Capital Gains Taxation," 69 *Harv. L. Rev.* 985, 995-96 (1956) [hereinafter cited as "Surrey"].

The approach used by Congress in defining "capital asset" was to include all "property" as capital assets, but then to exclude various types of property. In *Corn Products*, this Court recognized that this broad definition if literally applied would create results contrary to the intent of Congress: profits arising from normal everyday transactions, such as the Company's corn futures activities, would qualify for preferential capital gains treatment, rather than receive the ordinary income treatment they deserve. To avoid such unintended results, this Court understandably chose to be guided by the purpose of Section 1221, rather than its literal terms. In effect, the Court

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The approaches may be grouped into certain broad categories: (1) Is the asset "property" which is a "capital asset" under Section 1221? See *Commissioner v. Gillette Motor Transport Inc.*, 364 U.S. 130 (1960); *Comm'r v. Ferrer, supra* note 16; (2) Do the amounts received by the taxpayer upon the sale of the contract rights represent a substitute for future ordinary income that otherwise would have been received by the taxpayer? See *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958); *Commissioner v. Ferrer, supra*; (3) Does the transaction constitute a "sale or exchange"? See *Fairbanks v. United States*, 306 U.S. 436 (1939); (4) Was the property acquired with an intention that it would serve an integral function in the taxpayer's regular business activities? See *Corn Products Refining Co. v. Commissioner, supra* note 9.

recognized that to limit itself to a purely literal reading of the words before them was "both inadequate and harmful, at least until the literary skill and the imagination of our legislative draftsman go far beyond their present development." Brown, "The Growing 'Common Law' of Taxation," 34 *S. Cal. L. Rev.* 223, 236 (1961). Viewed in this light, it is eminently justifiable that this Court deliberately fashioned its opinion in *Corn Products* as a vehicle to properly effectuate the intent of Congress in differentiating between capital and ordinary assets.

These, then, are the two principles which are at the heart of *Corn Products*, and which have been the touchstone for the extensive development of the tax law in this area for three decades. First, ordinary versus capital treatment depends not upon a talismanic application of the wording of Section 1221, but upon a determination as to whether that characterization will further the purpose of Congress: to distinguish between transactions related to everyday business operations and transactions which are "not the normal source of business income." 350 U.S. at 52. Second, that crucial determination necessarily depends upon the purposes and circumstances of the taxpayer in each case — was the asset acquired to accomplish a business objective of the taxpayer? The same asset which is a source of ordinary business income for one taxpayer may be the object of a once-in-a-lifetime investment for another.

The decision of the Eighth Circuit Court of Appeals in this case is fundamentally at odds with the essential principles of *Corn Products*. Indeed, the court of appeals suggested that the continuing validity of *Corn Products*, and its application beyond the facts of that case, was in doubt. Although the majority opinion did not make explicit whether it viewed only the "progeny" of *Corn Products* as "misbegotten," or *Corn Prod-*

ucts itself, there can be little question that the court of appeals chose not to apply fully and fairly the Court's decision in *Corn Products* in this case.

Because it was the duty of the court of appeals to follow the controlling precedents of this Court, this itself was error. If *Corn Products* is still the law, a decision based upon the proposition that all property necessarily is a "capital asset" unless it falls within a specific exclusion to the definition of that term in Section 1221 simply cannot stand. Thus, the central issue before the Court is *not* whether the decision of the Eighth Circuit is consistent with *Corn Products*; it plainly is not. It is whether this Court should now overrule *Corn Products* and retreat from the principles on which it was based. Arkansas Best respectfully submits that *Corn Products* was decided correctly, reflects the intention of Congress as fully today as it did in 1955, and should now be reaffirmed.

II. THIRTY YEARS OF JURISPRUDENCE HAS DEMONSTRATED THE EXPEDIENCY AND WORKABILITY OF THE *CORN PRODUCTS* DOCTRINE

The correctness of this Court's decision in *Corn Products* is underscored by thirty years of unimpeached case law. Six circuit courts, the Court of Claims, the Tax Court and numerous district courts have employed the *Corn Products* doctrine to loosen the "statutory strait jacket" into which the literal language of Section 1221 has placed the essentially factual distinction between capital and ordinary assets.[12] These courts

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[12] *W.W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977); *Wright v. Commissioner*, 756 F.2d 1039 (4th Cir. 1985); *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971); *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970); *John J. Grier Co. v.*

have not hesitated in applying to a wide variety of factual situations the principle that assets acquired and retained to serve a function integral to the everyday operation of a business should not receive treatment as a capital asset. In the vast majority of these cases, the asset acquired has been corporate stock.[13] A brief review of some of these cases illustrates the practical and theoretical soundness of the doctrine.

United States, 328 F.2d 163 (7th Cir. 1964); *Hollywood Baseball Association v. Commissioner*, 423 F.2d 494 (9th Cir.), *cert. denied*, 400 U.S. 848 (1970); *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970); *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962); *Tulane Hardwood Lumber Co. v. Commissioner*, 24 T.C. 1146 (1955), *acq.*, 1958-1 C.B. 6; *Pittsburgh Reflector Co. v. Commissioner*, 24 T.C.M. (CCH) 377 (1968); *Hagan v. United States*, 221 F.Supp. 248 (W.D. Ark. 1963); *Duffy v. Lethert*, 11 AFTR 2d 1316 (D.C. Minn. 1963); *Journal Co. v. United States*, 195 F.Supp 434 (E.D. Wis. 1961); *S. S. Pierce Co. v. United States*, 52 AFTR 1700 (D.C. Mass. 1957).

[13] For example, the *Corn Products* doctrine has been applied where stock or securities were acquired to assure continued business or employment relationships with the issuer of the stock, *Steadman v. Commissioner*, 425 F.2d 1 (6th Cir.), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to protect taxpayer's position as general counsel); *Southeastern Aviation Underwriters Inc. v. Commissioner*, 25 T.C.M. (CCH) 412 (1966) (stock acquired to obtain a contract); *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869 (1970) (stock acquired to preserve an exclusive sales agency), to obtain the use of a valuable asset or the expertise of personnel of the issuing corporation, *John J. Grier Co. v. United States*, 328 F.2d 163 (7th Cir. 1964) (stock in a corporation acquired to obtain a lease held by the corporation); *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971) (stock acquired to obtain the services of a highly skilled team of scientists), to reduce import taxes and assembly costs, *Pittsburgh Reflector Co. v. Commissioner*, 27 T.C.M. (CCH) 377 (1968), and to obtain a source of supply, *Booth Newspapers, Inc. v.*

In *Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962), a newspaper publisher, suffering through a severe shortage in the supply of newsprint, bought the stock of a small newsprint mill to provide it with newsprint until its regular sources of supply could be reestablished. When the shortage ended, the stock was sold at a loss. The Court of Claims found that the stock purchase was a reasonable method to solve what was a vital business problem. Although the stock did not literally fall within any of the exclusions to the capital asset definition, it clearly was purchased as "an integral and necessary act in the conduct of the taxpayer's business," *id.* at 921, and deserved treatment as an ordinary loss. By no stretch of the imagination could this purchase have been characterized as the action of a "legitimate capitalist." *Corn Products*, 350 U.S. at 51. However, absent this Court's decision in *Corn Products*, only such an illogical result would have been possible.

The Fifth Circuit Court of Appeals also has applied and developed the *Corn Products* principles as a workable method to effectuate the intended distinction between capital and ordinary assets. In *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971), a corporation engaged in measuring physical phenomena purchased a controlling portion of the stock of a computer firm in an attempt to integrate much-needed computer expertise into its measurement system. When the computer firm lost its value, the stock was sold at a loss. The corporation then bought the stock of a second computer firm with the primary intention of obtaining market know-how, a unique research team and possibly some military systems contracts. The second firm subsequently went bankrupt.

United States, 303 F.2d 916 (Ct. Cl. 1962) (newsprint); *F. S. Services, Inc. v. United States*, 413 F.2d 548 (Ct. Cl. 1969) (petroleum products).

In evaluating the character of these two stock purchases, the Fifth Circuit found that both purchases were necessary and integral to the taxpayer's everyday business and that the stock was not purchased for any investment purposes in either instance. The Fifth Circuit rejected two tests suggested by the Government that would have artificially limited the application of the *Corn Products* doctrine. The first, the "temporary expedient" test, would have required the asset to be necessary to acquire inventory or protect a source of supply. The second, the "protection-expansion" test, would have denied ordinary treatment to assets purchased to expand as opposed to protect an existing business. The Fifth Circuit found both tests to be derived from unreasonably mechanical readings of prior case law. *Schlumberger*, 443 F.2d at 1121.

In *Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984), the case the Eighth Circuit cited as "most closely analogous to the one before us," 800 F.2d at 220; Pet. App. at A-9, a holding company of food products, marketing and storage businesses agreed to purchase the stock of a Spanish supermarket chain. When the chain's financial condition worsened, the terms of the purchase agreement allowed the holding company to terminate its obligation to buy the supermarket chain. However, in order to protect its goodwill and reputation as a manager of food operations, the holding company concluded that it was in its best interest to complete the purchase of the stock, but with the intention to sell it immediately. The stock ultimately was sold at a loss.

On these facts, the Fifth Circuit reasoned that since expenditures to protect existing goodwill and business reputation are deductible business expenses, stock acquired for the same purpose was entitled to ordinary asset treatment. Moreover, the court employed a list of objective factors and characteristics derived from prior *Corn Products* cases to assist in its

"facts and circumstances" analysis of the taxpayer's motives: the needs of the taxpayer's business, the length of time the asset was held, the nature of the taxpayer's other business and investment activities, the resulting business and investment advantages that might reasonably be expected to flow from the acquisition or expenditure, and the taxpayer's statements of its subjective intent at the time of acquisition and disposition. 744 F.2d at 458. The Fifth Circuit, in setting forth this list of objective factors, stated that it did not intend to

> place ordinary or capital treatment at the whim of the taxpayer. We are acutely aware of the possibility that a taxpayer's recollection of his intent at the time an asset was acquired may be colored by whether he ultimately recognizes gain or loss upon disposition of the asset. . . . [W]e are confident that courts can, by evaluating the objective factors outlined above, continue to avoid the whipsaw potential that reliance upon subjective intent might well create.

Id. As both *Schlumberger* and *Campbell Taggart* illustrate, the *Corn Products* doctrine has evolved and gained clarification with each application.

The Tax Court also has employed widely the principles of this Court's decision in *Corn Products*. The Tax Court has embraced the *Corn Products* doctrine on numerous occasions for determining whether stock is an ordinary or capital asset under Section 1221. *See, e.g., Southeastern Aviation Underwriters, Inc. v. Commissioner*, 25 T.C.M. (CCH) 412 (1966) (stock of Canadian company purchased to enable shipping of parts at savings on freight costs and duties); *Pittsburgh Reflector Company v. Commissioner*, 27 T.C.M. (CCH) 377 (1968) (stock purchased to obtain aviation insurance management contract to replace lost insurance business). Moreover, in an analogous area, the Tax Court has found these principles equally appro-

priate in distinguishing between investment and business loans in applying the investment interest limitations of Section 163(d).[14] *See Miller v. Commissioner*, 70 T.C. 448 (1978).

The establishment and evolution of the *Corn Products* doctrine in the lower courts has not spurred a rash of victories by taxpayers. Rather, taxpayers have lost their fair share of cases involving the characterization of corporate stock. *See, e.g.*, *Roth Steel Tube Co. v. Commissioner*, 49 T.C.M. (CCH) 698, *aff'd on another issue*, 800 F.2d 625 (6th Cir. 1986) (shareholder bought stock to combine operations but had substantial investment motive); *Gulftex Drug Co. Inc. v. Commissioner*, 29 T.C. 118, *aff'd*, 261 F.2d 238 (5th Cir. 1957) (purchase and retention of stock to obtain whiskey rights held for many years was investment-motivated); *Barry v. Commissioner*, 32 T.C.M. (CCH) 1332 (1973) (employer's stock not purchased to save taxpayer's job); *Duffy v. Lethert*, 11 AFTR 2d 1317 (D.C. Minn. 1963) (purchaser of stock looked to future gain and was investment motivated); *Ponca Tank v. Commissioner*, 26 T.C.M. (CCH) 866 (1967) (taxpayer could not show that stock purchase to acquire captive customer for storage tanks was not for investment).

In addition, the results reached by the courts, prior to this case, have generally been consistent with one another, regardless of whether a gain or loss is involved. For example, in *Mansfield Journal Company v. United States*, 274 F.2d 284 (6th Cir. 1960), the gain on the sale of contract rights that were originally obtained to secure a needed supply of newsprint was

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[14] Section 163(d) disallows any deductions for "investment interest" expenses incurred to the extent they are in excess of investment income. "Investment interest" generally means any interest which is paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment. Section 163(d)(3).

held to be an ordinary gain. The principles of the decision in *Mansfield* were adhered to by the Court of Claims in *Booth Newspapers*, *supra*, in which the taxpayer purchased stock in a mill to accomplish the same objective. Although *Booth Newspapers* was a loss case, the two courts' *Corn Products* analyses yielded the same conclusion of ordinary asset treatment.

The principles enunciated in *Corn Products* and its progeny requiring ordinary asset treatment where corporate stock is acquired for a business purpose are properly applicable to the facts before the Court in this case. Arkansas Best is a holding company which is "the nucleus of a diversified conglomerate with subsidiaries engaged in the business of transportation, consumer goods and financial services." 83 T.C. at 650; Pet. App. at B-12. After acquiring a controlling interest in the Bank in 1968, Congress passed the Amendments in 1970, thereby forcing Arkansas Best to choose between continuing to make acquisitions of nonbanking businesses or divesting itself of the Bank stock. Given the nature of its business as an acquisitive conglomerate, Arkansas Best chose the latter course of action. As a result of this irrevocable commitment by Arkansas Best to divest its Bank stock, this case presents an unusually clear instance of stock acquisitions (the post-1971 acquisitions) which were not, and could not have been, motivated by the hope of reaping an investment profit.

Before Arkansas Best could find a purchaser for its interest in the Bank, the financial condition of the Bank began to deteriorate rapidly. 83 T.C. at 656; Pet. App. at B-20. In light of these economic difficulties, Arkansas Best responded to the Bank's need for substantial capital infusions by acquiring additional Bank stock, knowing full well that it could not hope for profit on these purchases, and that its failure to do so would have resulted in the demise of the Bank. *Id.* Arkansas Best responded as it did because it was well aware of the special

responsibility imposed upon it as the controlling shareholder of the Bank — "a peculiarly public institution." *Id.*

As the Tax Court pointedly concluded:

> As a growing conglomerate, Arkansas Best depended upon its good reputation with creditors in order to assure a reliable source of financing for acquisitions. In addition, Arkansas Best's reputation as a conglomerate especially skilled in management determined its standing with other businessmen and in the stock market. (Arkansas Best was listed on the American Stock Exchange beginning in 1969 and on the New York Stock Exchange beginning in 1972.) Association with the failure of a bank would have severely blemished Arkansas Best's reputation in the financial and business communities in which it operates.
>
> Moreover, the demise of the bank would have exposed Arkansas Best (as controlling shareholder) to potentially damaging and costly litigation by minority shareholders.
>
> Expenditures to preserve business reputation are typically currently deductible business expenses. *Dunn & McCarthy, Inc. v. Commissioner*, 139 F.2d 242 (2d Cir. 1943). The purchase of stock may be a necessary tactic in the protection of business reputation, and in certain narrow circumstances may invoke the doctrine of *Corn Products*.
>
> Arkansas Best was not compelled to make purchases of NBC stock after 1972 nor could it have been motivated by the prospect of obtaining a profitable return on its purchases. The conglomerate carried through on a losing proposition solely to preserve its business reputation and therefore we hold that it is entitled to an ordinary loss on the disposition of NBC shares acquired in the years 1973 through 1976.

84 T.C. at 656-657; Pet. App. at B-20-21.

III. THE EIGHTH CIRCUIT'S REPUDIATION OF THE APPLICATION OF THE *CORN PRODUCTS* DOCTRINE TO CORPORATE STOCK RESTS ON ERRONEOUS REASONING

The Eighth Circuit's decision in this case rests upon two faulty legal arguments: (1) the result reached by the Tax Court required an unacceptable departure from the literal language of Section 1221, and constituted unwarranted judicial legislation; and (2) affirmance of the Tax Court's decision would foster uncertainty surrounding the characterization of stock as a capital or ordinary asset. These two lines of reasoning upon which the decision of the Eighth Circuit must stand (or fall) are hardly new. In *Corn Products*, the taxpayer raised virtually the identical arguments, only to have them rejected by this Court.

A. The Eighth Circuit's Failure to Follow this Court's Approach to Interpreting Section 1221 Distorts Congressional Intent

The decision of the Eighth Circuit below was, first and foremost, the result of a conclusion that corporate stock did not fall within the literal language of any exclusion to Section 1221's definition of capital asset.[15] Coupled with its belief that

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[15] The inability of the Eighth Circuit Court of Appeals to accept the fact that this Court in *Corn Products* deliberately refused to adopt a literal reading of the predecessor to Section 1221 in order to carry out the intended purpose of that section is linked to its misreading of this Court's decision in *United States v. Mississippi Chemical Corporation*, 405 U.S. 298 (1972). The only issue before this Court in *Mississippi Chemical* was whether or not the cost of the stock was currently deductible. This Court gave no consideration to the issue of whether the stock constituted a "capital asset" within the meaning of Section 1221. That issue was not addressed

"the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make," 800 F.2d at 221; Pet. App. at A-10, this conclusion ended the inquiry for the court of appeals. If no specific exclusion applied, the only result could be capital gain or loss treatment. The taxpayer in *Corn Products* similarly, but unsuccessfully, argued to this Court that corn futures contracts were to be treated as capital assets simply because they did not fall within any of the exclusions from the statutory definition of "capital asset." *See* Brief for Corn Products at 11.

The wooden application of the statutory language advocated by the Eighth Circuit could not possibly effectuate the intent of Congress in enacting Section 1221, but would open new vistas of tax avoidance by causing tax results to flow from the "inherent nature" of a type of asset, rather than from the purpose for which a particular taxpayer acquires and holds it. Clearly, "to permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities would seriously impair the effective administration of

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by either of the parties on brief, nor was it of any relevance to the Court's decision, since no disposition of that stock had occurred.

As the Government correctly stated in its brief:

> Respondents are not helped by cases purporting to apply the rationale of *Corn Products* . . . permitting ordinary loss treatment on the sale of corporate stock . . . . [T]he issue in these cases is whether or not the stock sold was a *capital* asset within the meaning of Section 1221. (It was assumed in each case that the stock was an asset.) Here, on the other hand, there has been no sale, and the issue is whether the stock purchased is an asset, not whether it is a capital asset.

Brief for United States at 37, fn. 33, *United States v. Mississippi Chemical Corporation*, 405 U.S. 298 (1972) (No. 71-52). Nonetheless, the Eighth Circuit cited *Mississippi Chemical* as supporting its literal interpretation of Section 1221.

the tax policies of Congress." *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334 (1945) (sale of a building was in substance made by corporation; shareholder was mere conduit).

The position of the Government in *Corn Products* was, of course, adopted by this Court. More importantly, it was the *right* position from the multiple standpoints of proper statutory interpretation, true Congressional purpose, and tax equity. Even though the result in this individual case will be the imposition of less tax instead of more, it is to be hoped that the Government will again take the principled position here, rather than one oriented to the effect on the revenues of the Treasury.

This Court properly recognized in *Corn Products* that the ultimate goal of statutory interpretation is to effectuate the intent of the legislature, and not just to apply the words of the legislation.[16] Although the language of the statute is the starting point for ascertaining the intent of Congress, it is neither exclusive nor necessarily complete. Where the statutory language, if literally applied, would yield unreasonable results or apparently frustrate the purpose of Congress, neither this Court nor other great jurists have hesitated to interpret statutes in a nonliteral manner.[17]

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[16] *Church of The Holy Trinity v. United States*, 143 U.S. 457, 472 (1892) ("[W]e cannot think Congress intended to denounce with penalties a transaction like that in the present case. It is a familiar rule, that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers."); *United States v. American Trucking Association*, 310 U.S. 534, 542 (1940) ("In the interpretation of statutes, the function of the courts is easily stated. It is to construe the language so as to give effect to the intent of Congress.").

[17] *See United States v. American Trucking Association, supra* fn. 17, at 543 ("Frequently, however, even when the plain meaning did not

The special characteristics of tax legislation make this principle of statutory interpretation particularly appropriate. The general terms used in tax statutes must be applied to the vast array of human economic activity, and therefore must be applied in specific circumstances that Congress could not reasonably have contemplated. Moreover, the inherent complexity of the concepts involved in our tax system and imperfections in the process of drafting tax legislation counsel against any assumption that tax statutes mean precisely what they say, and nothing more. For these reasons, tax statutes often have been interpreted by this Court and others in a nonliteral manner.[18]

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produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole,' *Ozawa v. United States*, 260 U.S. 178, 194 (1922), this Court has followed that purpose, rather than the literal words.") *See also Commissioner v. Tufts*, 461 U.S. 300 (1983) (the requirement that the amount realized upon disposition of property equal the full amount of a nonrecourse mortgage even though in excess of the property's fair market value created a logical result, although not within the meaning of "amount realized" under Section 1001(b)). As Judge Learned Hand so candidly stated:

> Flinch as we may, what we do, and must do, is to project ourselves, as best we can, into the position of those who uttered the words and to impute to them how they would have dealt with the concrete occasion.

United States v. Klinger, 199 F.2d 645, 648 (2nd Cir. 1952), *aff'd per curiam*, 345 U.S. 979 (1953).

[18] *See Hillsboro National Bank v. Commissioner*, 460 U.S. 370 (1983) (corporation must recognize income under tax benefit rule despite express non-recognition treatment provided by Section 336(a)); *Commissioner v. Tufts*, 461 U.S. 300 (1983) (amount realized upon disposition equals the full amount of a nonrecourse mortgage in excess of the property's fair market value even though not within the meaning of "amount realized" as defined in Section 1001(b)); *Bob Jones University v. United States*, 461 U.S. 574 (1983) (a

Section 1221 provides an excellent example of the reasons why a statute should not be interpreted literally in all cases. The approach used by Congress was to include all "property" as a "capital asset" other than certain excluded property. Unfortunately, this highly inclusive definition would, if taken literally, lead to absurd results. For example, contract rights to various kinds of "ordinary" income would seem clearly to be "capital assets" under this provision.

> [T]he right to a salary earned, or to interest accrued, or a dividend due, is "property" in the legal sense. Does such a right when sold therefore transport the salary, interest, or dividend out of the ordinary income area and into the capital gain category via the term "property" in the definition of capital asset?

Surrey at 1004. None of the exclusions in Section 1221 is literally applicable to a sale of such rights. Nevertheless, it is obvious that a sale of such rights was not intended by Congress to, and should not, result in capital gains to the seller. The recognized exclusion of such items as rights to salaries and dividends from classification as "capital assets" is

> the result of a gentlemen's agreement by the courts that they will not in this area take literally the use of the term 'property' in the definition of capital assets . . . . Otherwise, these claims when sold would produce capital gains and thereby would permit all earnings to escape ordinary income taxation. *Id.* at 1004-05 fn. 52.

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qualifying "educational" organization under Section 501(c)(3) must additionally be charitable in the common law sense in order to qualify for tax exempt status); *Paulsen v. Commissioner*, 469 U.S. 131 (1985) (merger of state and chartered stock savings and loan with federally chartered mutual savings and loan did not qualify as tax-free reorganization since continuity of interest test not met even though transaction satisfied literal requirements of reorganization provisions).

Just as the courts refuse to be bound by the literal language of Section 1221 where necessary to avoid absurd and unintended results, they also are willing to go beyond its specific terms where necessary to carry out the obvious purpose of the statute. In this case, that purpose is to limit capital gains treatment to transactions not closely connected with the taxpayer's ordinary business. Such judicial interpretation is necessary precisely because the task of devising statutory language to fulfill this purpose is so inherently complex, especially where it is apparent that Congress has not attempted to do so in a comprehensive way.

In light of this Court's identification of the fundamental principles of Section 1221, it is clear that the Eighth Circuit's mechanical approach to interpreting that section in this case is inadequate. Instead of suggesting that this Court's decision in *Corn Products* was limited to its facts, 800 F.2d at 219; Pet. App. at A-7, it was the task of the court of appeals to acknowledge, as did Judge Hanson in dissent, that "*Corn Products* was merely an attempt to divine congressional intent." 800 F.2d at 221; Pet. App. at A-11. Unless there was some convincing indication that this Court incorrectly assessed that intent — and the Eighth Circuit certainly offered none — the rationale in *Corn Products* should have been applied in the court of appeals below.

This Court was presented in *Corn Products* with a rough Congressional tool whose imperfections were obvious. The Court stated clearly in *Corn Products* the way in which that tool was intended by its makers to be used, and left to later judicial craftsmen the task of refining and perfecting the tool to better serve the original purpose of its legislative makers. Over the last three decades, those craftsmen have done their job well, improving not only the utility and precision of the tool, but their own skills in wielding it, and the results evi-

dently have been acceptable to the Congress. The decision of the court of appeals below would mandate, in the name of Congressional intent, that the courts scrap all improvements and henceforth use only the original blunt instrument.

B. Congress has Recognized and Approved the Operation of the *Corn Products* Doctrine

In fact, the court of appeals below had ample additional evidence that *Corn Products* was rightly decided. As that case itself held, it is an established principle that Congress implicitly validates longstanding judicial interpretations of tax legislation when it reenacts that legislation without substantial change. *See, e.g., Corn Products*, 350 U.S. at 53; *Helvering v. Winmill*, 305 U.S. 79 (1938). "Congress is presumed to be aware of settled judicial construction and thus adopts that construction unless it affirmatively acts to change it." *Fink v. Commissioner*, 789 F.2d 427, 433 (6th Cir.), *cert. granted*, 107 S.Ct. 454 (1986). When this Court renders a decision in the tax arena with which Congress disagrees, especially one with the enormous practical significance of *Corn Products*, Congress has been quick to act so as to make clear its intentions.[19]

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[19] *See United States v. Hendler*, 303 U.S. 564 (1938), where the Government successfully argued that in an otherwise tax-free corporate reorganization, the acquiring corporation's assumption of liabilities of the target ought to trigger gain to the target. As a result of this decision, innumerable tax-free reorganizations were rendered invalid, imposing an enormous tax burden on target companies if the statute of limitations had not run. To correct this problem, Congress amended Section 112(b)(5) of the Revenue Act of 1928, Pub. L. No. 70-562, 45 Stat. 791 (1928), overturning the *Hendler* decision retroactive to 1924. *See* Revenue Act of 1939, Pub. L. No. 76-155, §213(c), 53 Stat. 862 (1939); *See also* Ginsburg, "Making Tax Law Through the Judicial Process," 70 *American Bar Association Journal* 74, 76 (1984).

In this instance, the doctrine of *Corn Products* has been the subject of extensive commentary and judicial exegesis for decades.[20] Literally dozens of cases during the last thirty years uniformly have held that the categorization of gain or loss resulting from the sale of an asset as ordinary or capital depends upon the taxpayer's purposes and other factual circumstances.[21] During that period, Congress has amended Section 1221 three times without ever suggesting that all of those consistent judicial interpretations were "misbegotten" or contrary to the intent of Congress.[22] It was the court of appeals in

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[20] *See* cases cited in fn. 7, *supra* at p. 10; *see also*, Surrey, "Definitional Problems in Capital Gains Taxation," 69 *Harv. L. Rev.* 985 (1956); Miller, "The Unpleasant Taste of *Corn Products*," 53 *S. Cal. L. Rev.* 311 (1979); Troxell & Noall, "Judicial Erosion of the Concept of Securities as Capital Assets," 19 *Tax L. Rev.* 185 (1964); and Javaras, "Corporate Gains and Losses — The *Corn Products* Doctrine," 52 *Taxes* 770 (1974).

[21] *See, e.g., Campbell Taggart, Inc.*, 744 F.2d at 457 ("The cases indicate that the test of *Corn Products* is whether the asset was acquired with a business purpose or an investment purpose."); *F.S. Services, Inc. v. United States*, 413 F.2d 548, 554 (Ct. Cl. 1969) ("proper and valid business considerations rather than intent to make a capital investment"); *Mansfield Journal Company v. Commissioner*, 274 F.2d 284, 286 (6th Cir. 1960) ("motive . . . of a capital investor . . . [or] of a far-sighted manufacturer").

[22] Section 1221 has been amended three times since this Court's decision in *Corn Products*. The Tax Reform Act, Pub. L. No. 91-172, § 514(a), 83 Stat. 487, 643 (1969), amended Section 1221(3) to read as above at pages 2-3. The amendment was applicable to sales and other dispositions occurring after July 25, 1969. Prior to amendment, Section 1221(3) read as follows:

> (3) a copyright, a literary, musical, or artistic composition, or similar property, held by —
>
> (A) a taxpayer whose personal efforts created such property, or

this case which first "discovered" such alleged defects in these decisions — defects to which Congress itself has not objected.

Of even greater significance than the reenactment of Section 1221 without change is the fact that in 1976 a bill[23] was reported out of the House Ways and Means Committee which specifically addressed the issue of "Tax Treatment of Securities Acquired for Business Reasons and not as an Investment."[24] The proposed bill would have added a new provision to

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> (B) a taxpayer in whose hands the basis of such property is determined, for the purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property.

The Tax Reform Act of 1976, Pub. L. No. 94-455, §2132(a), 90 Stat. 1520, 1925 (1976), amended Section 1221 by adding paragraph (6) (what is now paragraph (5)), applicable to sales, exchanges, and contributions made after October 4, 1976. The same Act, at §1901(c)(9), amended Section 1221(5) by striking out "or Territory," following the word "State," with respect to taxable years beginning after December 31, 1976.

The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, §505(a), 95 Stat. 172, 331 (1981), repealed former Section 1221(5) and redesignated Section 1221(6) as Section 1221(5), applicable to property acquired or positions established after June 23, 1981, in the years ending after that date. Prior to amendment, former Section 1221(5) read as follows:

> (5) an obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue; or

[23] H. R. 10902, 94th Cong., 2d Sess. (1976).

[24] H. R. Rep. No. 1360, 94th Cong., 2d Sess. 1976) [hereinafter cited as "H. R. Rep. No. 1360"].

the Internal Revenue Code which required a taxpayer to notify the Secretary within thirty days after initially acquiring a security if the acquisition was not made as an investment. Only by filing the notice could a taxpayer preserve the right to seek ordinary loss treatment on a subsequent sale or exchange of that security. In a discussion of the law in existence at that time, the Committee Report stated:

> Under present law, the treatment of gain or loss on the sale or exchange of a stock or other security depends on whether the security is a capital asset in the hands of the taxpayer.... If a stock or other security is held for business purposes, it generally is not treated as a capital asset....

H.R. Report No. 1360 at 2.

Thus, the Committee clearly demonstrated its understanding of the applicable law — an understanding which is irreconcilable with the holding of the Eighth Circuit in this case. In further discussing the reasons for the bill, the Committee Report stated:

> The question of whether a security (or any asset) is a capital asset is factual and depends on the facts and circumstances of the particular case, i.e., whether the taxpayer acquired and held the security as an investment or whether he acquired and held it for sale to customers in the ordinary course of business or held the stock for use in his business.

Id. at 3. The bill was passed by the House of Representatives, but was never approved by the Senate.

This Court has viewed as very significant the fact that Congress, as it did here, had previously considered, but eventually rejected, a legislative response to an issue perceived by the Treasury Department to be a problem. In *Commissioner v.*

Brown, 380 U.S. 563 (1965), this Court considered the question of whether the sale of all of the assets of a taxpayer to a tax-exempt entity for a price which was payable only from the income produced by the assets sold qualified as a "sale" for purposes of the capital gains provisions. In deciding that case, this Court noted that the Treasury Department had in 1963 proposed a change in the law which would have taxed as ordinary income payments on the sale of a capital asset which were deferred over more than five years and were contingent on future income. *Brown*, 380 U.S. at 578. This Court noted that while Congress did not adopt the suggested change, "it is significant for our purposes that the proposed amendment did not deny the fact or occurrence of a sale but would have taxed as ordinary income those income-contingent payments deferred for more than five years." *Id.* This Court concluded that, in such cases, it was wise to "leave to the Congress the fashioning of a rule which, in any event, must have wide ramifications." 380 U.S. at 579, *citing American Automobile Association v. United States*, 367 U.S. 687, 697 (1961).

The situation with respect to H.R. 10902 is identical. Nowhere in the legislative history of that proposed bill did Congress indicate that it disagreed with the extensive judicial authority which held that whether an asset is a capital asset depends on a factual determination of whether it was held for a business purpose. Instead, the existence of that rule was expressly acknowledged.

In fact, the Treasury Department had expressly requested that the Committee consider whether Section 1221 should be amended to provide that capital stock should *never* be accorded ordinary loss or gain treatment. Joint Committee on Internal Revenue Taxation, 94th Cong., 1st Sess., *Description of Technical and Minor Bills listed for a Hearing By the Committee on Ways and Means on December 10, 1975*, 56, 58 (December 9,

1975). Congress declined to do so, thereby confirming that this Court in *Corn Products* correctly identified the legislative intent underlying Section 1221. Indeed, the unavoidable conclusion is that Congress declined to adopt the very principle which the Eighth Circuit Court of Appeals has "enacted" in this case. It plainly is *that* ruling which represents true "judicial legislation."

C. Any Administrative Problems Envisioned by the Eighth Circuit Plainly have been Insufficient to Prompt Congress or the Internal Revenue Service to Adopt any Corrective Measures

The second rationale for the decision of the court of appeals below was its belief that the settled interpretation of Section 1221 evidenced by *Corn Products* and its progeny "foster[s] subjectivity and uncertainty" and leads to "increased recourse to the administrative and judicial processes." 800 F.2d at 221; Pet. App. at A-10. This, too, is not a new argument. The taxpayer in *Corn Products* contended strenuously that "great uncertainty in the administration and application of the capital limitations will follow" if the Government's position in that case was upheld. Reply Brief for Corn Products at 28. This Court was not moved by this alarum, and our system of tax administration seems to have survived.

In fact, concern that determinations regarding individual taxpayer motivation will cause excessive "recourse to the administrative and judicial processes" seems largely confined to the Eighth Circuit. The Tax Court and many other courts have applied the principles of *Corn Products* to a myriad of factual situations with no greater difficulty than is ordinarily encountered in the common judicial process of applying governing

legal principles in specific cases.[25] None seemed shaken by the prospect prior to the decision by the court of appeals below. Moreover, it is apparent from H.R. 10902 that Congress is capable of devising administrative solutions to deal with any such concerns, and that it does not yet view them as sufficiently significant to require any action.[26]

More fundamentally, such an argument ignores the fact that application of Section 1221 to specific situations inherently and unavoidably involves subjective determinations and other fac-

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[25] The fact that a tax concept requires an analysis of a taxpayer's motives, information which does not appear on a tax return, does not handicap the Internal Revenue Service's ability to maintain a position contrary to that of a taxpayer. If the sheer number of cases which have considered the real estate dealer versus investor issue under Section 1221(1) is any indication, the Commissioner has experienced no such difficulty. *See, e.g., McManus v. Commissioner*, 65 T.C. 197 (1975), *aff'd*, 583 F.2d 443 (9th Cir. 1978), *cert. denied*, 440 U.S. 959 (1979) (taxpayer found to be a dealer on twelve sales over seven-year period). *See also Byram v. United States*, 707 F.2d 1418 (5th Cir. 1983).

[26] Sometimes, however, administrative problems do rise to a level which requires Congressional action. For example, consider the impetus for construction of objective hobby loss rules, currently contained in Section 183. Congress evidently was moved by the apparent fact that judicial attempts to divine taxpayers' motive in pursuing a so-called hobby activity did not yield a single victory for the Government. 88 Cong. Rec. S 8034-35 (1943) (statement of Sen. Danaher). Congress' response was to formulate an objective test for distinguishing between hobby losses and ordinary business losses by establishing a rebuttable "for profit" presumption if the activity generates a profit three or more years out of five consecutive years. If Congress ever concludes that the issue presented by this case requires analagous action, it no doubt will act. It is not the proper function of the Eighth Circuit to come to such a conclusion itself, and then unilaterally to alter the interpretation of Section 1221 which Congress understands and accepts.

tual issues. For example, Section 1221 states that a sale of property will result in ordinary income or loss if it is "inventory." It is impossible, however, to ascertain whether an item is "inventory" without knowing the facts regarding the taxpayer's business and his purposes in acquiring and holding the item. For example, if a taxpayer were to announce that he owned a bar of gold, it would not be possible to determine whether that bar of gold was held by the taxpayer as inventory or as an investment qualifying as a capital asset without first obtaining additional information as to the purpose or use to which the taxpayer intended to put the asset. If the taxpayer was engaged in the business of selling precious metals, the gold bar might constitute inventory in his hands. On the other hand, a taxpayer might intend to hold the gold bar to finance his retirement through its future potential appreciation in value, and it then would qualify as a capital asset. In either case, it is impossible to determine whether the asset qualifies as a capital asset without knowing the taxpayer's motives for the purchase. It is equally impossible to determine whether corporate stock is or is not a capital asset without making a determination as to the use to which that asset is, or will be, put.

IV. THE PROPER TEST UNDER *CORN PRODUCTS* IS THE DOMINANT MOTIVE TEST

If this Court correctly upholds Arkansas Best's reliance on this Court's decision in *Corn Products*, and over thirty years of consistent case law, the decision of the court of appeals must be reversed. Based on the unchallenged factual findings of the Tax Court as to the purpose for Arkansas Best's post-1972 acquisitions of Bank stock, the Tax Court's holding that the losses resulting from the sales of that stock were ordinary losses should be affirmed on remand. As to the 1972 stock acquisition, the Eighth Circuit should review the Tax Court's

findings under the appropriate legal standard. Accordingly, this Court should determine as part of its decision in this case the proper test for differentiating between capital and ordinary assets under the *Corn Products* doctrine.

Two principal tests for determining whether an asset should be characterized as an ordinary asset have emerged from the many cases interpreting *Corn Products*. These two tests are the "dominant business motive" test and the "substantial investment motive" test. Under the first test, an asset is characterized as an ordinary, non-capital asset if the dominant or primary motive for its acquisition was business-related. The second test also require the presence of a dominant business motive, but in addition requires the absence of any substantial investment motive. Thus, in a "mixed motivation" case — one in which the taxpayer's primary motive is business-related, but a substantial investment motive also exists — the second test would cause a different result than the dominant motive test. Based upon this Court's adoption of the dominant motive test for resolution of the "business versus investment" issue in analogous areas of tax law, and the fundamental flaws of the substantial investment motive test, this Court should hold that the dominant motive test is the correct one under the *Corn Products* doctrine.

In *Corn Products*, this Court established that an asset must be "integral" to, or arise from the everyday operation of, the taxpayer's business in order to be property for which Congress intended ordinary or non-capital treatment. 350 U.S. at 50, 52. Subsequent to *Corn Products* and prior to the Tax Court's decision in *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977), courts both expressly and implicitly employed a primary or dominant motive analysis as the operative demarcation between capital

and ordinary assets. *See Booth Newspapers*, 303 F.2d at 921; *Steadman*, 424 F.2d at 5. Although a number of the factual situations considered by these courts had contained evidence of both business and investment motivations,[26] no court had felt compelled to address the issue of mixed motivations. Even the Internal Revenue Service initially agreed with these courts' approach and adopted the primary motive test in Revenue Ruling 75-13, 1975-1 C.B. 7 (predominant motive test applied to characterize the worthlessness of stock held by an employee in his employer corporation).[27]

In *W. W. Windle Co.*, the Tax Court faced this issue of mixed motivations head on. The court found that although the taxpayer, a wool processor, had acquired the stock of a wool mill primarily to secure a captive customer, a recognized business purpose, the taxpayer held a secondary and substantial motive to acquire the stock as an investment. 65 T.C. at 703. Treating the mixed motive issue as one of first impression, the court acknowledged that adoption of a dominant motive test would

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[26] *See* Natbony, "Whither *Windle*?", 24 *St. Louis U. L. Rev.* 67, 72-73 (1979).

[27] Consistent with its current position and the apparently favorable holding in *W. W. Windle Co., supra*, the Internal Revenue Service subsequently revoked Revenue Ruling 75-13 in 1978. *See* Revenue Ruling 78-94, 1978-1 C.B. 58. However, in revoking Revenue Ruling 75-13, Revenue Ruling 78-94 announced that this change in position would not be applied adversely to taxpayers who acquired stock before March 13, 1978, if such stock was disposed of before September 13, 1978. In this case, all of the Bank stock acquired by Arkansas Best was sold prior to this latter date. Although the Commissioner clearly has the authority under Section 7805(b) to change his position retroactively, where he expressly chooses not to do so, that publicly-announced decision should be binding. Accordingly, the Commissioner should be estopped from applying the post-*Windle* standard announced in Revenue Ruling 78-94 to Arkansas Best's acquisition and sale of Bank stock in this case.

both give "effect to the Supreme Court's admonition" that the capital asset exclusions be broadly construed and maintain a uniform standard in the courts. 65 T.C. at 712. Yet, without citing a single legal authority to refute these "persuasive arguments," *id.*, the Tax Court rejected the dominant motive test and held that where a substantial, albeit secondary, investment motive exists, corporate stock will be deemed to be a capital asset.

This Court has twice held that the proper standard for differentiating between business and investment purposes in situations of dual taxpayer motivations is the dominant business motive test. In *Malat v. Riddell*, 383 U.S. 569 (1966), the taxpayer entered a joint venture for the principal purpose of development of rental property. Since the property had been purchased at a good price, the venturers had a secondary motive to sell the property in the event the development venture fell through. 383 U.S. at 570. When financing was not obtained and some venturers grew disgruntled, the venture sold the property at a gain.

The Government contended that the taxpayer's share of such gain was ordinary because the venturers' secondary, but nevertheless "substantial," intent to sell the property placed the property within the first exclusion to the capital asset definition for property held "primarily for sale to customers in the ordinary course of [taxpayer's] trade or business." The sole issue before this Court was whether a "controlling" or "substantial" business motive is needed to satisfy "primarily" as used in Section 1221(1). The Government urged a broad reading of "primarily," in line with this Court's admonition to broadly construe the exclusions to the definition of capital asset. Brief for Riddell at 16-17, *Malat v. Riddell*, 383 U.S. 569 (1966) (No. 487). A unanimous Court rejected the Government's interpretation, preferring to define "primarily" in com-

monsense fashion to mean "of first importance" or "principally" for purposes of Section 1221(1). 383 U.S. at 572. The Court reiterated the basic and pervading distinction between capital and ordinary treatment:

> The purpose of [Section 1221] is to differentiate between the "profits and losses arising from the everyday operation of a business" on the one hand (*Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 52) and "the realization of appreciation in value accrued over a substantial period of time" on the other. (*Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 134)

383 U.S. at 572.

In effecting this purpose, both the statutory and judicial exclusions, the substance of which the capital asset definition is made, must each be interpreted consistently with one another. "Primarily," which defines the relationship between the taxpayer's property and business under the Section 1221(1) exclusion, is effectively equated with "integral," which defines the necessary relationship under the judicially devised exclusion in *Corn Products*. Therefore, a business motive that is "primary" or "of first importance" in the purchase and holding of property should constitute the necessary integration of the property and taxpayer's trade or business so as to be excluded from characterization as a capital asset under the *Corn Products* doctrine, regardless of the existence of a substantial, but secondary, investment motive.

In *United States v. Generes*, 405 U.S. 93 (1972), this Court expressly advocated use of the dominant motive test in distinguishing between the business and investment characterization of loans by an employee-shareholder to its employer. The taxpayer, a major stockholder and president of a construction company, loaned over $150,000 to his company for the primary

purpose of protecting his stock investment. The trial court additionally found a secondary and significant taxpayer motive of preserving his employment position. When the debt became worthless, the taxpayer claimed a business bad debt loss under Section 166(a), which could then be used to offset ordinary income. The Government contended that the obligation was a non-business debt that must be treated as a short-term capital loss under Section 166(d). The issue before this Court, therefore, was whether the "proximate" relation between the debt and the taxpayer's business that was required for business characterization was satisfied either by a "dominant" business motivation or a "significant" business motivation.

The Court first emphasized that the Internal Revenue Code carefully distinguishes between business and non-business debts for the purposes of Sections 162, 165, and 166. The Court found that since any taxpayer who holds a status as both an employee and shareholder almost assuredly will have a significant interest in preserving his employment, a "significant motivation" test would effectively obliterate the domain of the non-business debt in this context. In addition, the Court found that the "dominant motivation" standard best preserved the meaningful distinction between business and non-business activities. This Court summarized this standard as having

> the attribute of workability. It provides a guideline of certainty for the trier of fact. The trier then may compare the risk against the potential reward and give proper emphasis to the objective rather than to the subjective. . . . By making the dominant motivation the measure, the logical tax consequence ensues and prevents the mere presence of a business motive, however small and however insignificant, from controlling the tax result at the taxpayer's convenience.

405 U.S. at 104. Such language represents nothing short of a ringing endorsement of the dominant motive test.

In applying the dominant business motive test in this case, the Tax Court's factual findings must be accepted since there is no claim that those factual findings were clearly erroneous. Fed. R. Civ. Proc. 52(a); *Commissioner v. Duberstein*, 363 U.S. 278, 291 (1960). Therefore, assuming that this Court concludes that the proper interpretation of Section 1221 involves determining the motives of a taxpayer for acquiring an asset, the factual conclusions reached by the Tax Court below with respect to the Bank stock acquired after 1972 are determinative of the issues before this Court. As this court noted in *Corn Products:*

> For tax purposes petitioner's purchases have been found to "constitute an integral part of its manufacturing business" by both the Tax Court and the Court of Appeals, and on essentially factual questions the findings of two courts should not ordinarily be disturbed.

350 U.S. at 51. With respect to the stock acquired in 1972, this case should be remanded to the Court of Appeals so that the rules of law announced by this Court can be applied properly.

CONCLUSION

In light of the Tax Court's conclusion that Bank stock acquired after 1972 was acquired solely for business purposes, the decision of the Eighth Circuit Court of Appeals with respect to Bank stock acquired after 1972 should be reversed, and the losses incurred on the subsequent sales of that stock should be accorded ordinary loss treatment. With respect to Bank stock acquired in 1972, and the Bank stock acquired from Universal, the decision of the Eighth Circuit Court of Appeals should be reversed and remanded, with directions that the

Corn Products doctrine be applied utilizing a dominant motive test. With respect to the acquisitions of Bank stock made by Arkansas Best in 1972, Arkansas Best believes that it can show on remand that those acquisitions, while perhaps not solely business motivated as were the post-1972 acquisitions, nonetheless were predominantly business motivated given the fact that Arkansas Best had filed a notice in 1971 wherein it irrevocably committed itself to divesting its interest in the Bank stock.

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No. 86-751

In the Supreme Court of the United States

OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether 661,000 shares of common stock of a bank that petitioner sold in 1975 were "capital assets" as defined in Section 1221 of the Internal Revenue Code, with the result that the loss realized by petitioner on the sale of the stock was not an ordinary loss, but rather was a capital loss subject to limited deductibility under Section 165(f) of the Code.

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In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-751

ARKANSAS BEST CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A12) is reported at 800 F.2d 215. The opinion of the Tax Court (Pet. App. B1-B28) is reported at 83 T.C. 640.

JURISDICTION

The judgment of the court of appeals (J.A. 23) was entered on September 9, 1986. The petition for a writ of certiorari was filed on November 7, 1986, and was granted on March 23, 1987 (J.A. 24). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTE INVOLVED

Section 1221 of the Internal Revenue Code (26 U.S.C.) provides:

Capital asset defined.

For purposes of this subtitle, the term "capital asset" means property held by the taxpayer

(whether or not connected with his trade or business), but does not include—

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or real property used in his trade or business;

(3) a copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property, held by—

(A) a taxpayer whose personal efforts created such property,

(B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or

(C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of a taxpayer described in subparagraph (A) or (B);

(4) accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1);

(5) a publication of the United States Government (including the Congressional Record) which is received from the United States Government or any agency thereof, other than by purchase at the price at which it is offered for sale to the public, and which is held by—

(A) a taxpayer who so received such publication, or

(B) a taxpayer in whose hands the basis of such publication is determined, for purposes of determining gain from a sale or exchange, in whole or in part by reference to the basis of such publication in the hands of a taxpayer described in subparagraph (A).

STATEMENT

1. Petitioner is a diversified holding company. It was organized in 1966 to hold all of the stock of Arkansas Best Freight System, Inc., a successful trucking line operating in the Midwest. Petitioner immediately embarked upon an expansion program with the plan of becoming a conglomerate. It acquired all of the stock of various corporations engaged in furniture manufacturing, insurance, data processing, used tire retreading, and new tire sales. The tire subsidiary also held the real estate occupied by petitioner and its subsidiaries. Petitioner provided financial planning and, in some cases, accounting and personnel services to its subsidiaries, and they in turn paid a management fee to it. The subsidiaries often acted as suppliers or customers for one another, and they generally interacted in a synergistic fashion. Pet. App. A2, B3-B4, B19; J.A. 2-3.

From 1966, the year of petitioner's organization, until 1973, Robert A. Young, Jr. served as Chairman of petitioner's Board of Directors. Between March 1967 and April 1968, Young personally acquired 209,000 shares of the common stock of the National Bank of Commerce of Dallas, Texas (the Bank), as well as rights to buy additional Bank shares. These shares and rights were transferred to petitioner in June 1968. As a result of these transactions, and of petitioner's purchase of additional Bank shares later that year, petitioner at the end of 1968 owned 266,614 shares of the Bank's common stock, or 64.97% of the then-outstanding common shares. Pet. App. A2, B4-B5; J.A. 4-8.

At the time petitioner acquired the Bank shares, it was aware of pending legislation concerning bank holding companies that, if enacted, would substantially affect corporations that acquired, or had acquired, controlling interests in banks. Petitioner had called a special meeting of its shareholders to consider the proposed acquisition of Bank stock. Petitioner informed them in a proxy statement that enactment of the pending legislation would cause it to be classified as a "bank holding company" if it acquired the Bank shares, and might require it, as such, to divest itself of voting shares of companies that were not banks or bank holding companies. Pet. App. B5-B6.

On the other hand, petitioner also informed its shareholders that there were good reasons for acquiring the Bank stock. Petitioner had obtained disinterested appraisals of the Bank stock and projections of the Bank's expected growth and earnings, which suggested that the acquisition would be a good investment. Dallas at the time was developing rapidly as a

financial center, and banks were at the center of the boom, so it seemed likely that the Bank shares would appreciate in value. Moreover, petitioner was planning a public offering of its own shares and believed that its financial statements would be rendered more attractive by virtue of ownership of the Bank stock. The acquisition was also expected to yield favorable results in other respects, including improved price/earnings ratios, enhanced prestige and access to financing in the financial community, and some protection from hostile takeover attempts. Pet. App. B5-B6; J.A. 8-9.

After the acquisition, the Bank did not interact with petitioner and its subsidiaries in the same synergistic fashion as did the other subsidiaries. The Bank offered no financing to the corporate group and, as was typical of banks, it contributed little by way of earnings distributions. Petitioner supplied no management services to the Bank, and the Bank did not pay it any management fees. At no time did petitioner have more than three representatives on the Bank's board of directors, which averaged 20 members. Pet. App. B7.

In December 1970, Congress enacted the Bank Holding Company Act Amendments of 1970, Pub. L. No. 91-607, 84 Stat. 1760. Pursuant to this new statute, petitioner was classified as a bank holding company and was required either to cease making acquisitions of non-bank businesses or to divest itself of control of the Bank. See 12 U.S.C. 1841(a). Petitioner chose the latter alternative. On July 30, 1971, petitioner filed with the Federal Reserve Bank of Dallas an irrevocable declaration that it would divest itself of control of the Bank by January 1, 1981. J.A. 10. Petitioner was then free to make further

acquisitions of non-bank businesses, and it proceeded to do so. Pet. App. B7; J.A. 10-11.

Between 1969 and 1974, petitioner acquired 585,795 additional Bank shares by means of various purchases, stock dividends, conversions, and responses to capital calls. These acquisitions served to increase petitioner's holdings to 852,409 shares, or 65.77% of the common shares then outstanding. Thus, although petitioner more than tripled the number of shares that it owned during this period, its percentage interest in the Bank remained substantially the same, increasing by only 0.8%. Pet. App. B8-B9.[1]

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[1] The Tax Court listed petitioner's acquisitions of Bank shares during 1969-1974 as follows (Pet. App. B9; see J.A. 9-12):

Year	*Number of shares acquired*	*Transaction*
1969	142,670	Two capital calls
1969	24,188	Purchase
1971	43,347	Stock dividend
1972	19,072	Stock dividend
1972	95,363	Capital call
1972	6,165	Purchase
1973	23,902	Stock dividend
1973	103,887	Capital call
1973	135	Purchase
1974	124,664	Conversion of $3,116,610 principal amount of convertible debentures, which had been acquired in 1973 on capital call
1974	2,402	Purchase
Total	585,795	

Some of the listed transactions that the Tax Court referred to as capital calls were referred to in a stipulation of facts submitted by the parties as exercises of stockholder preemptive rights (J.A. 9, ¶ 20). Presumably, when added capi-

The capital calls made by the Bank during 1969-1974 reflected the concerns of federal regulators that the Bank was inadequately capitalized. From 1968 until 1972 the Bank appeared to be successful and growing, and the capital calls during that time were designed to accommodate its growth. In 1972, however, after petitioner had commenced negotiations with Texas Commerce Bancshares (TCB) to divest itself of the Bank shares on favorable terms in a stock-for-stock transaction, TCB's representatives examined the Bank's loan portfolio and discovered serious problems. TCB thereupon withdrew from the negotiations. Subsequently, federal examiners undertook their own examination and classified the Bank as a problem bank, primarily because it had a heavy concentration of loans in the Dallas real estate business, which suffered a severe collapse at about that time. Pet. App. A2-A3, B9-B10.

The capital calls issued by the Bank after 1972 were in response to these loan-portfolio problems. Petitioner responded to the capital calls for a number of reasons. First, participation of the majority shareholder was essential to save the Bank, and thus petitioner was compelled to participate if it wished to preserve its equity stake. Second, failure to participate, with the resultant demise of the Bank, likely would have exposed petitioner to litigation by minority shareholders. Third, permitting the Bank to fail

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tal was required, shares were offered to existing shareholders on a pro-rata basis. Presumably, also, the stock dividends served the purpose of increasing capital by capitalizing earnings. That would explain why, although petitioner more than tripled the number of shares that it owned during this period, its percentage ownership increased only from 64.97% to 65.77%.

would reflect badly on petitioner so that its sources of financing might be jeopardized and its reputation for skilled management might be tarnished. Pet. App. B10-B11.[2]

Notwithstanding the Bank's problems, petitioner still hoped, at least as late as July 1974, to dispose of its Bank stock at a profit, and it apparently expected capital-gain treatment on such a profitable sale. At a meeting of petitioner's board of directors in that month, its general counsel reviewed the possible tax treatment of a bank stock divestiture. He expressed the hope that, pursuant to pending legislation, the anticipated capital gain could be spread over a ten-year period, or, alternatively, that the proceeds of sale could be invested in a new asset and that taxation of the capital gain could be delayed until the disposition of the new asset. Pet. App. B10. Throughout the period in question, petitioner referred to the Bank stock as an "investment" in its financial records and other corporate documents (Pet. App. B7; Exhs. Q1-Q8).[3]

On June 30, 1975, petitioner sold to a group of investors 661,000 shares of Bank stock, representing 51% of the outstanding common stock, leaving peti-

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[2] The existence of these three reasons was a finding of fact made by the Tax Court (Pet. App. B10-B11). In its opinion, however, the Tax Court made the somewhat contradictory statement that the post-1972 acquisitions were "solely to preserve [petitioner's] business reputation" (*id.* at B21).

[3] At petitioner's annual stockholders' meeting in May 1974, the Chairman of the Board noted that "the Bank is an investment for us" and stated that petitioner expected a substantial profit upon the sale of the Bank stock (Exh. P(AC), at 10, 11). In addition, petitioner listed the Bank stock under "Investments" on its federal income tax returns for 1970-1975 (Exhs. 2B, 3C, 4D, 5E, 6F, 7G).

tioner with a 14.7% stake. For the 661,000 shares sold, petitioner received cash and a note, secured by the shares sold, with an aggregate value in excess of $5.9 million (Pet. App. B11; J.A. 13, ¶ 30(b)). Petitioner's cost or "basis" in the 661,000 shares was about $15 million (J.A. 4, ¶ 7).

On a consolidated federal income tax return filed on behalf of itself and its subsidiaries for 1975, petitioner claimed a deduction for an ordinary loss in the amount of $9,995,688 from the sale of the 661,000 shares of Bank stock. In his notice of deficiencies, the Commissioner disallowed the claimed ordinary-loss deduction, finding that the loss resulting from the sale was a capital loss, subject to the limitations of Sections 165(f) and 1211(a) of the Internal Revenue Code.[4] Those Sections generally provide that a corporate taxpayer may deduct capital losses only to the extent of its capital gains, while permitting excess capital losses to be carried over to other years.

2. Petitioner sought redetermination of the asserted deficiencies in the Tax Court. The Tax Court agreed with the Commissioner that the Bank shares acquired by petitioner before the end of 1972 were capital assets whose disposition gave rise to a capital loss. But the court held that the Bank shares acquired by petitioner after 1972, with the exception of one minor acquisition,[5] were non-capital assets whose

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[4] Unless otherwise noted, all statutory references are to the Internal Revenue Code (26 U.S.C.), as amended (the Code or I.R.C.).

[5] The court held that 2,402 shares acquired by petitioner from Universal Insurance Co. (UIC) were a capital asset. The court assumed that UIC was not a subsidiary of petitioner at the time (Pet. App. B21), and hence reasoned that petitioner's purchase from UIC could not have served the

disposition gave rise to an ordinary loss. In so holding, the Tax Court took as its points of departure its own previous opinion in *W.W. Windle Co.* v. *Commissioner*, 65 T.C. 694, 712 (1976), appeal dismissed, 550 F.2d 43 (1st Cir.), cert. denied, 431 U.S. 966 (1977), and the Court of Claims' opinion in *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916 (1962). Those two decisions had interpreted this Court's opinion in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955), to support the conclusion that securities disposed of by a taxpayer should be treated as a non-capital asset if the securities transaction is sufficiently related to the taxpayer's trade or business. The Tax Court framed the issue based on *Booth Newspapers* as whether "petitioner purchased and held the stock of [the Bank] as an integral and necessary act in the conduct of [petitioner's] business or whether the stock was purchased and held with an investment purpose" (Pet. App. B16). The court further noted that, under its decision in *W.W. Windle*, " 'stock purchased with a substantial investment purpose is a capital asset even if there is a more substantial business motive for the purchase' " (*id.* at B17 (quoting 65 T.C. at 712)).

The Tax Court did not find that the purchase and holding of Bank stock was "an integral and neces-

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business purpose of protecting a subsidiary from regulatory sanctions. We agree with petitioner (see Pet. Br. 7 n.4) that this portion of the Tax Court's opinion rests on an erroneous factual premise; the parties stipulated (Exh. 1A) that UIC was already a subsidiary of petitioner at the time of the purchase in question. We nevertheless believe, of course, that the court of appeals correctly held that all 661,000 Bank shares sold in 1975, including the 2,402 purchased from UIC, were capital assets.

sary act" in the conduct of petitioner's business or that of its subsidiaries; instead, the court extended the *Booth Newspapers* rationale to the facts of this case. The Tax Court asserted, in apparent conflict with its findings of fact (see Pet. App. B5-B6), that most of petitioner's acquisitions of Bank shares after 1972 "were made exclusively for business purposes and subsequently held for the same reasons" (Pet. App. B20). The court noted in this connection that the purchases were designed "to preserve [petitioner's] business reputation" and that expenditures for such a purpose are typically deductible as business expenses (*id.* at B20-B21). The court on that basis concluded that these shares were non-capital assets, the sale of which gave rise to an ordinary loss (*ibid.*). With respect to petitioner's acquisitions of Bank stock during 1968-1972, by contrast, the Tax Court concluded that the acquisitions "were motivated primarily by investment purpose" and therefore constituted capital assets giving rise to a capital loss when sold in 1975 (*id.* at B18, B19).

3. The Commissioner appealed with respect to the Tax Court's holding that most of the Bank shares acquired after 1972 were ordinary assets. Petitioner cross-appealed with respect to the Tax Court's holding that the shares acquired between July 30, 1971, and December 31, 1972, were capital assets.[6] The court of appeals, by a 2-1 vote, held in favor of the Commissioner, reversing "insofar as the Tax

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[6] Petitioner therefore abandoned on appeal the claim it had pressed in the Tax Court for ordinary-loss treatment for the Bank shares acquired between June 1968 and July 30, 1971, the date it filed its irrevocable divestment election with the Dallas Federal Reserve Bank.

Court allowed ordinary loss treatment for any of the capital stock transactions" (Pet. App. A2), but affirming the Tax Court's decision in all other respects (*id.* at A1-A11).

The court of appeals concluded that all of petitioner's shares of Bank stock fell within the definition of "capital asset" set forth in Section 1221 of the Code. That Section defines a "capital asset" as "property held by the taxpayer (whether or not connected with his trade or business)," with five specific exceptions. The court concluded that the Bank shares satisfied the general definition in Section 1221 and, as petitioner conceded, did not fall within any of the five exceptions. Pet. App. A4-A8. The court of appeals acknowledged that some courts, including the Court of Claims in *Booth Newspapers*, had "taken the position that capital stock is not a capital asset when acquired to assure a supply of raw materials vital to the taxpayer's business, to preserve an existing business, or even to pursue new business" (*id.* at A8; see *id.* at A8-A10 (citing cases)). But the court expressly rejected these decisions, characterizing them as "misbegotten" (*id.* at A10) and noting that they "lack a basis in the statutory language" (*id.* at A9). Dismissing petitioner's contention that these decisions simply applied a judicial exception supposedly created by this Court's *Corn Products* opinion, the court below emphasized that it "d[id] not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221" (*id.* at A10).[7]

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[7] In this regard, the court of appeals was not speaking of securities held as inventory by a securities dealer; it had earlier noted (Pet. App. A5) that such securities would be

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioner candidly acknowledges that the 661,000 shares of Bank stock it sold in 1975 fall within the statutory definition of "capital asset" contained in Section 1221 of the Code. Petitioner thus concedes that the loss it realized on the sale of those shares would give rise to a capital loss "based on the statutory language alone" (Br. 12). Petitioner nevertheless contends that a substantial portion of these shares—those acquired after July 30, 1971—should be treated as non-capital assets whose sale gave rise to an ordinary loss.

In making this contention, petitioner relies on a supposed extra-statutory exception to Section 1221's definition of "capital asset." Petitioner characterizes this supposed exception, which would be an addition to the five exceptions listed in the statute, as an "improvement[ ]" (Br. 35) worked by "judicial craftsmen" (Br. 34) upon the statutory definition—a definition that petitioner describes as a "statutory strait jacket" and "a rough Congressional tool whose imperfections were obvious" (Br. 21, 34). Petitioner asserts that this judge-made improvement was necessary to "effectuate the intent of Congress" (Br. 20) by "distinguish[ing] between assets acquired and held in connection with the taxpayer's usual trade or business and those acquired principally for investment" (Br. 11). Based on this theory, petitioner asserts that any asset acquired for "a dominant business motive" (Br. 43) is not a capital asset. And petitioner maintains that this amendment to the statutory definition was accompiished by this Court's

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excluded from the definition of a "capital asset" under the exception for "inventory" set forth in Section 1221(1).

opinion in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955), which on petitioner's view "cannot be reconciled" (Br. 11) with the decision below treating the Bank shares as capital assets. Each step of petitioner's argument is wrong.

First, as petitioner admits, the rule that it seeks to apply here cannot be squared with the language of the statute. That fact alone is dispositive of petitioner's contention. An inquiry into legislative intent is an aid to interpreting a statute, but it cannot provide a basis for ignoring the statute's language.

Second, petitioner's description of Congress's intent is mistaken in any event. Petitioner adduces no evidence to support its view that Congress intended in enacting Section 1221 to exclude all business-related assets from the definition of "capital asset." The language of the statute is surely hostile to that view: in defining "capital asset" as property held by the taxpayer "whether or not connected with his trade or business," the statute obviously contemplates the existence of "capital assets" that are business-connected. The legislative history, furthermore, shows that Congress meant what it said in defining "capital asset" to include all property other than property specifically excepted in the statute.

Third, this Court's decision in *Corn Products* does not support petitioner's contention. The Court there construed the provisions of the predecessor of Section 1221 and found that the property in question fell within one of the enumerated exceptions. The Court did not purport to create a new judicial exception to the words of the statute.

Finally, as the existing confusion in the lower courts suggests, the rule advanced by petitioner would produce an amorphous, ill-defined category of non-capital assets that is not amenable to consistent

judicial application. By making the definition of "capital asset" depend on the "subjective motivations of taxpayers" (Pet. Br. 12), which are quite difficult for a court to ascertain, petitioner's rule in practical effect would allow taxpayers to wait and see what tax treatment will be most favorable, and then decide for themselves, depending on whether they have a gain or loss, whether they prefer the asset to be treated as capital or ordinary. In short, petitioner's contention is untenable; the court of appeals correctly held that the definition of "capital asset" is that expressly formulated by Congress in Section 1221 of the Code.

ARGUMENT

ALL OF PETITIONER'S SHARES OF BANK STOCK SOLD IN 1975 WERE "CAPITAL ASSETS," AND THE RESULTING LOSS WAS THEREFORE A CAPITAL LOSS

A. *The Express Terms Of Section 1221 Unequivocally Require That Petitioner's Loss Be Treated As A Capital Loss*

1. The statutory framework that governs this case is not complicated. Section 165(a) of the Code allows as a deduction from gross income "any loss sustained during the taxable year and not compensated for by insurance or otherwise." This provision is qualified by Section 165(f), which provides that "[l]osses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212." Section 1211(a) provides: "In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges." Section 1212(a) establishes rules governing carryback and carryforward of capital losses, permitting them to be offset against capital gains in certain earlier or later years.

It is apparent from this statutory framework that the question whether the loss suffered by petitioner on the sale of the Bank stock was a "capital" loss, subject to the limitations of Sections 1211 and 1212, turns entirely on whether those shares were "capital assets" within the meaning of Section 165(f). That term is explicitly defined in Section 1221. It sets forth the general rule that, "[f]or purposes of this subtitle, the term 'capital asset' means property held by the taxpayer (whether or not connected with his trade or business)." Section 1221 then goes on to state that "the term 'capital asset' * * * does not include" property that falls within five specific exceptions. These exceptions cover, among other things, "property of a kind which would properly be included in the inventory of the taxpayer" (§ 1221 (1)); real property or other depreciable property used in the taxpayer's trade or business (§ 1221(2)); and "accounts or notes receivable acquired in the ordinary course of trade or business for services rendered or from the sale of property described in paragraph (1)" (§ 1221(4)).[8]

Petitioner does not dispute that its Bank stock falls within the body of the Section 1221 definition, *i.e.*,

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[8] The present version of Section 1221 is set forth in its entirety at pages 1-3, *supra*. The version in effect in 1975, when petitioner sold its Bank stock, contained a different exception (5), relating to certain federal and state debt obligations issued on a discount basis. See 26 U.S.C. (1970 ed.) 1221(5). That exception was repealed by the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 505(a), 95 Stat. 331. The present exception (5), relating to certain publications of the United States Government, was added by the Tax Reform Act of 1976, Pub. L. No. 94-455, § 2132(a), 90 Stat. 1925. None of these changes, obviously, has any bearing on the question presented here.

that the Bank stock was "property held by the taxpayer (whether or not connected with his trade or business)." By the same token, petitioner has never claimed, and could not plausibly claim, that the Bank stock is covered by any of the enumerated statutory exceptions. The plain language of the statute thus makes it clear that all of petitioner's Bank stock was a "capital asset," and hence that the entire loss suffered by petitioner upon the sale of the shares in 1975 was a "capital loss." Absent some compelling reason for reaching a contrary conclusion, such unambiguous statutory language should be dispositive. See, *e.g.*, *Randall* v. *Loftsgaarden*, No. 85-519 (July 2, 1986), slip op. 8; *United States* v. *Turkette*, 452 U.S. 576, 580 (1981).[9]

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[9] Petitioner's discussion of the text of Section 1221 is limited to a single footnote. See Pet. Br. 17 n.9. Petitioner there suggests that the five exceptions listed in Section 1221 are merely illustrative of the types of property excluded from the general definition of capital asset, not an exhaustive list of such property. Petitioner invokes in support of this proposition Section 7701(c) of the Code, which provides that "[t]he terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined." But Section 7701(c), which sets forth a common-sense rule of statutory construction, is completely irrelevant here. Section 1221 does not state that the category of non-capital assets "includes" the five classes of property specified therein; if it did, Section 7701(c) would be relevant. To the contrary, Section 1221 states that capital asset "means" all property, but "does not include" the five classes of property listed as exceptions. The natural reading of such a statute is that the body of Section 1221 establishes an "exclusive definition" (*Groman* v. *Commissioner*, 302 U.S. 82, 86 (1937)), and that the phrase "but does not include" takes out of that all-encompassing definition only what is specifically mentioned, no more and no less. For example, if a statute provided that "the term 'protected spe-

2. Although petitioner does not try to anchor its argument in the text of Section 1221, it contends that one must look beyond the statutory language to effectuate the intent of Congress. Petitioner asserts that Congress's intent in enacting Section 1221 was "to distinguish between assets acquired and held in connection with the taxpayer's usual trade or business and those acquired principally for investment" (Br. 11), or, alternatively, "to distinguish between transactions related to everyday business operations and transactions which are 'not the normal source of business income' " (Br. 20 (citation omitted)). The language of the statute, however, unmistakably defeats this contention. The words that Congress chose make it clear that Congress did *not* intend the definition of "capital asset" to turn on the distinction between "business" assets or transactions and "investment" assets or transactions.

Putting aside for the moment the five specific exceptions, the basic definition of "capital asset" contained in Section 1221 is "property held by the taxpayer (*whether or not connected with his trade or business*)" (emphasis added). The parenthetical clause serves no purpose other than to dispel the very contention that petitioner is making. That clause expressly makes the business purpose underlying the acquisition or use of an asset *irrelevant* in determining whether it is covered by the general definition. The existence of a business nexus, of course, will often be relevant in determining whether a particular asset is covered by one of the five listed exceptions, since those exceptions speak of "stock in trade," depreciable

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cies' means all animals but does not include dogs," it could not seriously be contended that the definition should be read to exclude cats as well as dogs.

property and real property "used in [the taxpayer's] trade or business," and of accounts or notes receivable "acquired in the ordinary course of [his] trade or business" (I.R.C. § 1221(1), (2), and (4)). But petitioner does not contend that any of the listed exceptions covers its Bank shares, and the existence vel non of a business connection is thus irrelevant in this case.

As this Court has noted, "[t]he 'plain purpose' of legislation * * * is determined in the first instance with reference to the plain language of the statute itself." *Board of Governors of the Fed. Reserve System* v. *Dimension Financial Corp.*, No. 84-1274 (Jan. 22, 1986), slip op. 12. Under this principle, the parenthetical clause in Section 1221 completely refutes petitioner's contention about the supposed intent of Congress. We can accept arguendo the truth of petitioner's assertion (see Br. 34) that the process of drafting legislation is sufficiently imperfect that statutes will often need judicial refinement to mirror congressional intent accurately. But petitioner is not seeking refinement here, it is seeking a complete redrafting of the statute. If Congress truly intended the definition of "capital asset" to exclude all property acquired or used for a business purpose, it is inconceivable that Congress would have defined "capital asset" to mean all property "whether or not connected with [a] trade or business." That clause, obviously, contemplates that *some* property connected with a trade or business can be a capital asset, and it thus negates in the clearest language imaginable the congressional intent hypothesized by petitioner.

3. The legislative history of Section 1221, to which petitioner makes no reference, confirms that Congress did not intend the definition of "capital asset" to turn on the existence vel non of a dominant business mo-

tive for an asset's acquisition or use. The body of the statutory definition, including the parenthetical clause, has remained unchanged in any fashion relevant here since its enactment in 1924. See Revenue Act of 1924, ch. 234, § 208(a)(8), 43 Stat. 263.[10] At that time, the only exception to the definition of "capital asset" was the exception for inventory and stock-in-trade, which closely resembled that now set forth in Section 1221(1).[11] Congress subsequently added other exceptions, some of which, like the inventory exception, were designed to cover business-related assets. In 1938, for example, Congress added an exception for depreciable property used in a trade or business, an exception corresponding to that now contained in Section 1221(2). See Revenue Act of 1938,

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[10] Prior to 1924, the definition provided that "[t]he term 'capital assets' * * * means property acquired and held by the taxpayer *for profit or investment* for more than two years (whether or not connected with his trade or business), *but does not include property held for the personal use or consumption of the taxpayer or his family* * * *." Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (emphasis added). The italicized language was deleted in 1924. The effect of those deletions was to expand the category of "capital assets" to include personal items not necessarily held for profit, such as a taxpayer's personal residence. Thus, the statutory definition in 1921 did contain a distinction between for-profit and investment use, on the one hand, and personal use, on the other. Contrary to the statement of Amicus Kraft Co. (Br. 11-14), however, the definition has *never* contained a distinction between investment use and business use.

[11] The final clause of the inventory exception was amended in the Revenue Act of 1934, ch. 277, § 117(b), 48 Stat. 714, by adding the phrase "to customers" to modify "sale," and by adding the word "ordinary" to modify "course of his trade or business."

ch. 289, § 117(a)(1), 52 Stat. 500. In 1942, Congress amended that exception to include real property used in a trade or business. Revenue Act of 1942, ch. 619, § 151(a), 56 Stat. 846. The exception for certain accounts or notes receivable "acquired in the ordinary course of trade or business," now set forth in Section 1221(4), was added by the Internal Revenue Code of 1954, 68A Stat. 322.[12]

The manner in which Section 1221 has evolved clearly shows that it cannot be read to embody a universal exception for all business-related assets. Rather, Congress has amended the statute on several occasions to remove specified categories of business-related assets from the general definition. These specific amendments, of course, would have been entirely unnecessary if the statute had always incorporated the universal exception that petitioner posits. Each time Congress has amended the statute, moreover, it has restricted its action to enacting the enumerated exception, leaving intact the parenthetical clause stating that property, unless specifically excepted, is a capital asset "whether or not connected with [the taxpayer's] trade or business." Thus, although the statute in its present form contains specific exceptions that remove many, and perhaps most, business-related assets other than stock and securities from the body of the definition, the parenthetical clause obviously retains its vitality for property not covered by those exceptions. There is absolutely no

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[12] The third exception, covering copyrights, musical compositions, and other intellectual property, was added in 1950. Revenue Act of 1950, ch. 994, § 210(a), 64 Stat. 932. The current fifth exception was added in 1976. See note 8, *supra*. Its predecessor, repealed in 1981, had been added by the Revenue Act of 1941, ch. 412, § 115(b), 55 Stat. 698.

reason to believe that Congress intended stock like that sold by petitioner in 1975 to be treated as other than a "capital asset," whether or not its acquisition was motivated by a business purpose.

The indicia of congressional intent outside the statute's text also demonstrate the unsoundness of petitioner's contention. When Congress was considering the first definition of "capital assets" in 1921, a question arose on the Senate floor whether there would be a distinction between a capital transaction that takes place "as a part of the [taxpayer's] business" and one that does not. 61 Cong. Rec. 5836 (1921) (Sen. King). The reply given by Senator McCumber, a member of the Senate Finance Committee, was that the only distinctions were those made in the statute's text, which provided an exception for business property of the type that would be included in inventory, as well as an exception (repealed in 1924) covering property held for the taxpayer's personal use. See Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233. "Nothing further than what is contained" in the statute was intended to be a ground for exclusion from the statutory definition. 61 Cong. Rec. 5836-5837 (1921) (Sen. McCumber).

The congressional reports accompanying the Revenue Act of 1934 reiterated that the exceptions to the general definition of "capital asset" were limited to those specified in the statute. That Act amended the definition of "capital asset" to remove a holding-period limitation contained in previous laws, and instead made the taxpayer's holding period relevant only in determining whether his capital loss on the asset's sale would be short-term or long-term.[19] The

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[19] Between 1921 and 1934, "capital assets" had been defined to mean property that was "held by the taxpayer for

discussion of that amendment in the House report stated (H.R. Rep. 704, 73d Cong., 2d Sess. 31 (1934) (emphasis added)):

> The following propositions are essential to the consideration of the new treatment:
>
> * * * * *
>
> (4) Subsection (b) defines capital assets. *It will be noted that the definition includes all property, except as specifically excluded.*

The Senate report stated that it "concur[red] in the general features of the plan proposed by the House bill, but believe[d] a few modifications should be made therein." S. Rep. 558, 73d Cong., 2d Sess. 12 (1934).[14] The congressional reports accompanying the enactment of the Internal Revenue Code of 1954 similarly stated that Section 1221 was derived from Section 117(a)(1) of the 1939 Code, which provided

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more than two years." See, *e.g.*, Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233; Revenue Act of 1924, ch. 234, § 208(a)(8) and (b), 43 Stat. 263; Revenue Act of 1932, ch. 209, § 101(a) and (c)(8), 47 Stat. 191, 192.

[14] The most notable modification was the amendment to the "inventory" exception discussed briefly in note 11, *supra*. In order "to prevent tax avoidance" (S. Rep. 558, 73d Cong., 2d Sess. 12 (1934)), Congress changed the language of that exception to specify that it covered only property "held by the taxpayer primarily for sale *to customers* in the *ordinary* course of his trade or business" (emphasis added). The purpose of adding the italicized words was to ensure that securities bought and sold by a "trader," *i.e*, someone trading for his own account, would be treated as capital assets. Securities bought and sold by a "dealer," by contrast, would continue to fall within the inventory exception to the definition of "capital asset." See H.R. Conf. Rep. 1385, 73d Cong., 2d Sess. 22 (1934); 4 J. Mertens, *Law of Federal Income Taxation* § 22.13, at 102 (1980).

that "a capital asset is property held by the taxpayer with certain exceptions." H.R. Rep. 1337, 83d Cong., 2d Sess. A273 (1954); S. Rep. 1622, 83d Cong., 2d Sess. 431 (1954).[15]

Congress's repeated admonitions that exceptions to the definition of "capital asset" are limited to those statutorily specified were embodied in Treasury Regulations issued under the 1934 Act. Article 117-1 of Regulations 86 provided that "[t]he term 'capital assets' includes all classes of property not specifically excluded by section 117(b)." That statement in the Regulations has remained substantially unchanged for more than 50 years, and it appears today at Treas. Reg. § 1.1221-1(a). In sum, there is simply no basis for divining a congressional intent that a general business-connection exception should be engrafted onto the definition of "capital asset" set forth in Section 1221.[16]

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[15] It bears mentioning that the Revenue Act of 1942, ch. 619, § 123(a)(1), 56 Stat. 820, added Section 23(g)(4) of the 1939 Code, the predecessor of the current Section 165(g)(3). Section 165(g)(3) provides that when stock of a 80%-owned subsidiary (formerly, a 95%-owned subsidiary) engaged in active business becomes worthless, the stock of the subsidiary shall not be treated as a capital asset. The enactment of this provision is difficult to square with petitioner's contention. Obviously, this provision contemplates that capital-asset treatment will continue to govern *sales* of stock in a subsidiary, as well as situations where a subsidiary's stock becomes worthless, yet the parent's percentage ownership is smaller than that specified in Section 165(g)(3). Under petitioner's view, these limitations would evaporate as long as the acquisition of the subsidiary's stock was business-connected.

[16] Although petitioner cites no direct evidence concerning the intent of the Congress that enacted Section 1221, it does assert (Br. 35-40) that Congress's failure to amend that Sec-

B. *This Court's* Corn Products *Decision Did Not Create An Extra-Statutory Exception To The Specific Terms Of Section 1221*

Eschewing any reliance on the language of Section 1221 or its legislative history, petitioner rests its entire argument on what it calls "the *Corn Products* doctrine." Petitioner refers to a series of lower-court decisions, beginning with *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916 (Ct. Cl. 1962), that have purported to apply this Court's opinion in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955). The lower courts, apart from the court of appeals below, have read that opinion to suggest that

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tion in later years, so as to overturn the lower-court decisions following in the wake of the Court of Claims' 1962 decision in *Booth Newspapers*, demonstrates that those decisions must have correctly identified the original intent of Congress. As this Court had noted on many occasions, however, "unsuccessful attempts at legislation are not the best of guides to legislative intent." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381-382 n.11 (1969). See also *Milwaukee* v. *Illinois*, 451 U.S. 304, 332 n.24 (1981); *Bryant* v. *Yellen*, 447 U.S. 352, 376 (1980). Thus, even when the terms of a statute are ambiguous, subsequent congressional inaction is an unreliable guide to the intention of its original drafters; that conclusion follows *a fortiori* where, as here, the terms of the statute are perfectly plain. Petitioner's "congressional acquiescence" argument, moreover, is particularly inapt in the present context, since the lower courts are in complete disarray about the scope of the supposed judicial exception to Section 1221. See pages 36-40, *infra*. Congress surely has not "recognized and approved" (Pet. Br. 35) *all* of these lower-court interpretations, which are mutually inconsistent. Rather than choosing some lower court decision to represent the governing rule on the theory that Congress approved that decision through inaction, the correct method of statutory interpretation is to focus on the text of the statute and the intent of the Congress that enacted it.

the terms of Section 1221 do not exclusively control whether an asset is a "capital asset," and that there exists a broad exception to the statutory definition in addition to the exceptions statutorily specified. Under this so-called "*Corn Products* doctrine," the characterization as a capital asset of property, including capital stock, is said to turn on the extent to which the taxpayer's acquisition of the property had a "business" rather than an "investment" purpose.

We agree with the court of appeals that this line of lower-court decisions is "misbegotten" (Pet. App. A10). This Court in *Corn Products* did not authorize an open-ended judicial inquiry, divorced from the text of Section 1221, into whether property is a "capital asset." Rather, it simply construed the statute, giving a broad reading to one of the explicit statutory exceptions. A careful examination of the *Corn Products* case shows that this Court's opinion cannot be read "as either requiring or permitting the courts to decide that capital stock [not held by a dealer] can be anything other than a capital asset under section 1221." Pet. App. A10.

Corn Products Refining Co. (the taxpayer) was a nationally known manufacturer of starch, sugar and other products derived from grain corn. Most of its products were sold under contracts specifying a fixed price, or the market price on the date of delivery, whichever was lower (350 U.S. at 48). It had a storage capacity of barely three weeks' supply of raw corn. In 1934 and 1936, when droughts had caused sharp increases in the price of spot corn, the taxpayer had suffered from unanticipated increases in the cost of raw materials. To avoid a recurrence of this problem, the taxpayer "began to establish a long position in corn futures 'as a part of its corn buying program'

and 'as the most economical method of obtaining an adequate supply of raw corn' without entailing the expenditure of large sums for additional storage facilities" (*ibid.*).

When prices appeared favorable at harvest time, the taxpayer would establish a long position in corn futures so as to assure an adequate supply of raw corn at a stable price. The taxpayer would take delivery on such futures contracts as it found necessary for its manufacturing operations, and it would sell off the rest of the futures contracts in early summer if no shortage appeared imminent. If shortages appeared, however, it sold off the futures contracts only as it bought spot corn for grinding. 350 U.S. at 48-49. In 1940, the taxpayer netted a profit of approximately $681,000 from futures transactions, which it treated as a reduction in the cost of raw materials (see 16 T.C. 395, 398 (1951)). In 1942, the taxpayer had a loss of approximately $110,000 from futures transactions, which it treated as an addition to cost of goods sold (see 11 T.C.M. (CCH) 721, 723-724 (1952)). "In computing its tax liability, Corn Products reported these figures as ordinary profit and loss from the manufacturing operations for the respective years" (350 U.S. at 49).

After the Commissioner had asserted tax deficiencies for 1940 and 1942 on unrelated grounds, the taxpayer filed petitions in the Tax Court, where it argued for the first time that its futures contracts were "capital assets" whose sale gave rise to capital gains and losses. The Tax Court decided the 1940 case against the taxpayer on other grounds (16 T.C. 395 (1951)). In the 1942 case, the Tax Court held that the taxpayer on its tax return had correctly treated the futures transactions as "hedges" giving

rise to an ordinary loss, rather than "speculative transactions of a capital nature" (11 T.C.M. at 726).

On consolidated appeals, the Second Circuit affirmed (215 F.2d 513 (1954)). It held that the taxpayer's futures transactions were "hedging" transactions that fell within a specified exception to the definition of "capital asset" contained in Section 117(a)(1) of the 1939 Code. That definition read in pertinent part as follows: "The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year * * *." Internal Revenue Code of 1939, ch. 1, § 117(a)(1), 53 Stat. 50.

The Second Circuit began by explaining why hedging transactions in futures contracts, as opposed to "legitimate capital transactions," came within the inventory exception set forth in Section 117(a). The court stated that a "hedge" is "part of the inventory purchase system which is utilized solely for the purpose of stabilizing inventory cost. It is an integral part of the productive process * * * [that] cannot reasonably be separated from the inventory items." The court concluded: "The tax treatment of hedges, then, is not a 'judge-made exception' to Section 117(a); it is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section." 215 F.2d at 516.

With this principle in mind, the court went on to address the particular facts of the *Corn Products* case. The court acknowledged that, because the taxpayer in its futures transactions sought to protect itself only from inventory price increases and not

from price declines, those transactions "did not constitute what is known as 'true' hedging" (215 F.2d at 516).[17] The court concluded, however, that the distinction between a "true hedge" and the type of hedge used by the taxpayer in *Corn Products* was not significant in determining whether the futures contracts represented capital assets. The court explained (*ibid.*):

> The property here was used for essentially the same purpose and in the same manner as in true hedging. Futures contracts were entered into to stabilize inventory costs and thus protect profit, and whether complete or only partial insurance was thereby obtained is simply a difference in degree, not in kind. Therefore, for the same reasons that the true hedge is not accorded capital treatment under Section 117(a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either.

Thus, the court concluded that the taxpayer's transactions in corn futures fell within the inventory exception to the statutory definition of "capital assets."

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[17] In G.C.M. 17322, XV-2 C. B. 151-152 (1936), the Treasury Department had issued an opinion as to "whether losses from hedging futures transactions on commodity exchanges constitute 'capital losses.'" The Department concluded that "hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets," and it gave examples of "true hedges against price fluctuations in spot goods" (*id.* at 155; see *id.* at 152). The results of such transactions were to be reflected in inventory adjustments (*id.* at 153). In view of the analysis adopted in the Treasury opinion, courts at the time generally sought to determine whether futures contracts were "capital assets" by inquiring whether they represented "true hedges." See, *e.g.*, *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F.2d 772, 774-775 (5th Cir. 1941); *Grote* v. *Commissioner*, 41 B.T.A. 247, 249 (1940).

This Court granted the taxpayer's petition for certiorari and affirmed.[18] In so doing, the Court resolved the following question presented in the petition (see 350 U.S. at 47 n.2):

> Are transactions in commodity futures which are not "true hedges" capital asset transactions and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions?

There is language in the Court's opinion stating that profits and losses from everyday business operations generally will not be "capital" in nature, and it is this language that the lower courts have invoked to justify the so-called "*Corn Products* doctrine." But a careful examination of the opinion as a whole shows that the Court simply gave a broad reading to the exceptions set forth in the statute itself, and that it adopted the court of appeals' rationale that the taxpayer's futures transactions were "hedges" that fell within the inventory exception to the statutory definition of "capital asset."[19]

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[18] The Court noted that the taxpayer had asserted a conflict in the circuits (350 U.S. at 47). Each of the decisions that the Court cited (*id.* at 47 n.3) involved the narrow question whether hedging futures transactions on commodity exchanges were transactions in "capital assets." See *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F.2d 33 (6th Cir. 1945); *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F.2d 772 (5th Cir. 1941); *Makransky's Estate* v. *Commissioner*, 154 F.2d 59 (3d Cir. 1946) (per curiam).

[19] It cannot seriously be disputed that there was no need for this Court in *Corn Products* to go beyond interpreting the specific exceptions in the statute in order to affirm the

The Court first discussed the purpose of the taxpayer's futures transactions. It recited the lower courts' findings that those transactions were "designed to protect [the taxpayer's] manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements" (350 U.S. at 50). The Court further observed that "it appears that the transactions were vitally important to the company's business as a form of insurance against increases in the price of raw corn" and that "the purchase of corn futures assured the company a source of supply which was admittedly cheaper than constructing additional storage facilities for raw corn" (*ibid.*). "[I]t is difficult to imagine," the Court said, "a program more closely geared to a company's manufacturing enterprise or more important to its successful operation" (*ibid.*).

In response to the taxpayer's "labeling its activity as that of a 'legitimate capitalist' exercising 'good judgment' in the futures market," the Court stated

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judgment of the court of appeals. Even those who view *Corn Products* as creating a novel judicial exception to the statute recognize that the inventory exception provided an adequate basis for decision. See, *e.g.*, 2 B. Bittker, *Federal Taxation of Income, Estates, and Gifts* ¶ 51.10.3, at 51-62 (1981) (approving "*Corn Products* doctrine," but noting that this Court's decision in that case "could have been reached with less strain by a narrower alternative rationale"); Kraft Co. Amicus Br. 3. The "*Corn Products* doctrine" thus rests on the dubious assumption that the Court deliberately adopted a broad rationale unnecessary to its decision in order to create a judicial exception to Section 1221; as we shall show, that assumption cannot stand in the face of what the Court actually said in *Corn Products* about the rationale of its holding.

that this characterization "ignore[d] the testimony of its own officers" (350 U.S. at 51). Those individuals had testified that "in entering [the futures] market the company was 'trying to protect a part of [its] manufacturing costs' " and "to fill an actual 'need for the quantity of corn [bought]' " in order to cover the products it expected to market (*ibid.*). The Court likewise dismissed as irrelevant the taxpayer's assertion "that its transactions did not constitute 'true hedging.' " "It is true," the Court explained, "that Corn Products did not secure complete protection from its market operations. • • • It is clear, however, that [it] feared the possibility of a price rise more than that of a price decline. It therefore purchased partial insurance against its principal risk, and hoped to retain sufficient flexibility to avoid serious losses on a declining market" (*ibid.*).

Having thus examined the function and significance of the taxpayer's market operations, the Court turned to the ultimate question in the case—whether the hedging contracts were "capital assets" under the statutory definition of that term. The Court introduced the central paragraph of its opinion as follows (350 U.S. at 51): "Nor can we find support for petitioner's contention that hedging is not within the exclusions of § 117(a)." The Court admitted that the futures did not "come within the literal language of the exclusions set out in that section" because they "were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business" (*id.* at 51-52). The Court noted some of the purposes underlying the capital-asset provisions, including the grant of preferential treatment to transactions that "are not the normal source of business income"; it also noted that

"Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss" (*ibid.*). The court concluded (*id.* at 52): "Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly." [20]

The Court first pointed out that the body of the definition of capital asset—"property held by the taxpayer (whether or not connected with his trade or business)"—had been given a narrow reading in cases involving contract claims or rights to what would be ordinary income, thereby preventing taxpayers from converting ordinary income into preferentially taxed capital gains. See 350 U.S. at 52 (citing *Kieselbach* v. *Commissioner*, 317 U.S. 399, 403 (1943)) (interest portion of lump-sum condemnation award); *Hort* v. *Commissioner*, 313 U.S. 28, 31 (1941) (unexpired lease). See also *Commissioner* v. *Gillette Motor Transport, Inc.*, 364 U.S. 130, 134-136 (1960) (claim for the fair rental value of property is not itself "property" within the meaning of former Section 117(a)). The Court therefore concluded that, while "property" should be construed narrowly, the

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[20] Petitioner quotes all but the opening sentence of the Court's discussion on this point (Pet. Br. 16-17). But to omit the opening sentence, which explicitly states that the taxpayer's hedging transactions were "within the exclusions of § 117(a)," inaccurately shifts the focus of the Court's discussion away from the text of the statute. See also, *e.g.*, 2 B. Bittker, *Federal Taxation of Income, Estates, and Gifts* ¶ 51.10.3, at 51-62 (1981) (making the same mistake); *W.W. Windle Co.* v. *Commissioner*, 65 T.C. 694, 707 (1976) (same). Viewed in its entirety, the Court's discussion clearly focused on interpreting the specific exceptions in the statute.

statutory exclusions from the definition of "capital asset" had to be interpreted broadly in order "to effectuate the basic congressional purpose" (350 U.S. at 52).

The Court then explained that the established treatment of "hedging" transactions required that the statutory exclusions be interpreted broadly enough to embrace commodity futures employed for that purpose. The Court noted that the Treasury Department, in G.C.M. 17322, XV-2 C. B. 151 (1936), had concluded that "hedging transactions were essentially to be regarded as insurance rather than a dealing in capital assets," and hence that "gains and losses therefrom were ordinary business gains and losses" (350 U.S. at 52); in that same ruling, the Treasury had concluded that a manufacturer's raw material inventory should be adjusted to reflect futures contracts employed for hedging (XV-2 C. B. at 153, 154-155). The Court noted that the Treasury ruling "had been consistently followed by the courts as well as by the Commissioner" for almost 20 years and was solidly entrenched (350 U.S. at 53). And the Court pointed out that, in Section 1233(a) of the 1954 Code, which had just recently been enacted, Congress had explicitly recognized that bona fide hedging transactions in commodity futures "do not result in capital gains or losses" (350 U.S. at 53 & n.9).

The Court's ultimate conclusion in *Corn Products* left little doubt as to the scope of its holding. It ruled "that *the statute* clearly refutes the [taxpayer's] contention" (350 U.S. at 53 (emphasis added)).[21] In af-

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[21] The Court added that "practical considerations lead to the same conclusion" (350 U.S. at 53). If corn futures constituted capital assets, yet raw corn constituted inventory, which is not a capital asset, the Court explained that the

firming the Second Circuit, this Court's opinion in *Corn Products* is thus fully consistent with the lower court's statement that the tax treatment of hedges is not "a judge-made exception" to the predecessor of Section 1221, but a recognition "that property used in hedging transactions properly comes within the exclusions of the section" (215 F.2d at 516). Indeed, this Court explicitly rejected the idea that Section 1221's text is inadequate to its task in *Malat* v. *Riddell*, 383 U.S. 569, 572 (1966), where, after referring to the *Corn Products* opinion, it stated that "[a] literal reading of [Section 1221] is consistent with [its] legislative purpose." Nothing in *Corn Products* casts any doubt on the Eighth Circuit's conclusion in this case that, in light of Congress's failure "to incorporate some sort of exception regarding capital stock" in Section 1221, "the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make" (Pet. App. A10).[22]

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hedger could choose capital or ordinary tax treatment at will. He could either sell the futures and purchase in the spot market, thus getting capital treatment; or he could take delivery under the futures contract, thus getting ordinary treatment. In the words of the Court, such a state of affairs would create a "loophole" that would "frustrate[]" the congressional purpose (*id.* at 54). Similar considerations led Congress in 1954 to provide explicitly in Section 1234 that, for purposes of capital gain and loss, an option should have the same character as the property to which the option relates. See H.R. Rep. 1337, 83d Cong., 2d Sess. A278-A279 (1954); S. Rep. 1622, 83d Cong., 2d Sess. 437-438 (1954).

[22] Petitioner errs in asserting (Br. 15-16) that the theory it urges here is the position that was advanced in the government's brief in *Corn Products*. In arguing that the "exclusions from the capital asset definition [should] be broadly applied" to cover transactions in corn futures (Gov't Br.

C. *The Test Petitioner Seeks To Apply For Determining Whether Property Is A "Capital Asset" Is Illogical And Unworkable*

Petitioner contends that the status of an asset as a "capital asset" should not be governed by Section 1221, but rather should be governed by the "*Corn Products* doctrine" that has been developed by the lower courts. One of the many problems with this contention is that there is no single identifiable "*Corn Products* doctrine." Rather, the lower courts are in considerable disarray on this issue, and the "doctrine" is little more than an amorphous collection of decisions that have repeatedly changed the applicable test, usually with a view to expanding the circumstances under which capital stock can be excluded from the definition of a "capital asset." See generally 2 B. Bittker, *supra*, § 51.10.3, at 51-61; Note, *The Corn Products Doctrine and Its Application To Partnership Interests*, 79 Colum. L. Rev. 341 (1979); Troxell & Noall, *Judicial Erosion of the Concept of Securities as*

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at 12, *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955)), the government did argue that the hedging transactions had to be analyzed in the context of the taxpayer's manufacturing business. And the brief did contain broad language describing Congress's general intent to except from the capital-asset definition certain everyday business expenses. But the brief recognized (*id.* at 17) that the relevant inquiry was "the proper construction to be given to Code Section 117," and the thrust of the brief was to defend the court of appeals' holding that hedging transactions designed to assure an adequate supply of inventory fall within the first statutory exception to the definition of "capital asset." The government's brief did not urge, as does petitioner, that the statutory definition can be ignored in favor of a judicially-created doctrine that relies on an extra-statutory distinction between "business" assets and "investment" assets.

Capital Assets, 19 Tax L. Rev. 185 (1964). This frolic by the lower courts has led to many decisions that "possibly might surprise the *Corn Products* [C]ourt." *Agway, Inc.* v. *United States*, 524 F.2d 1194, 1200 (Ct. Cl. 1975). In our view, none of the various formulations of the "*Corn Products* doctrine" should supplant the statutory definition that Congress adopted.

1. The line of lower-court cases upon which petitioner relies begins with *Booth Newspapers, Inc.* v. *United States*, 303 F.2d 916 (Ct. Cl. 1962). In that case, two newspapers bought all of the stock of a paper company in order to assure an adequate supply of newsprint in a time of shortage, and they sold the stock at a loss several years later when the shortage had eased. The Court of Claims brushed aside Section 1221's definition of capital asset as "an elastic concept" (303 F.2d at 920) and permitted an ordinary-loss deduction on the sale of the stock. The test formulated by the Court of Claims allowed ordinary-loss treatment in the case of any securities "purchased by a taxpayer as an integral and necessary act in the conduct of his business," as opposed to securities whose purchase was motivated by "an investment purpose" (*id.* at 921).

As might be expected from a doctrine so divorced from any statutory foundation, the rule announced in *Booth Newspapers* has continued to expand and change shape as different courts have tinkered with it. The possibility that the departure from Section 1221 might be confined to cases where the stock in question was acquired to help guarantee a source of supply soon evaporated, and "the *Corn Products* doctrine" at that point ceased to bear any sensible rela-

tionship to the *Corn Products* case.[23] The new doctrine was applied to afford ordinary-loss treatment on the sale of stock acquired by an individual to assure employment (*Steadman* v. *Commissioner*, 424 F.2d 1 (6th Cir.), cert. denied, 400 U.S. 869 (1970)), and on the sale of stock acquired by a corporate commission agency to assure an important account (*Waterman, Largen & Co.* v. *United States*, 419 F.2d 845 (Ct. Cl. 1969), cert. denied, 400 U.S. 869 (1970)). And the requirement enunciated in *Booth Newspapers*—that the stock acquisition be integral to an existing business—was substantially eroded when the "*Corn Products* doctrine" was invoked to allow an ordinary loss on the sale of stock acquired with the objective of expanding the taxpayer's existing busi-

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[23] A stock acquisition designed to ensure a source of supply of a necessary raw material, like that in *Booth Newspapers*, at least arguably bore some "conceptual nexus" to the facts of *Corn Products* itself. See *Waterman, Largen & Co.* v. *United States*, 419 F.2d 845, 860, (Ct. Cl. 1969), cert. denied, 400 U.S. 869 (1970) (Nichols, J., dissenting). But while such an equity investment could be viewed as relating to inventory, we do not believe that it would fall within even the broadest reading of the "inventory" exception contained in Section 1221(1). Stock that is held for several years cannot possibly be included in the annual adjustments that are the reason for inventory accounting, and such stock clearly is not "property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year" (I.R.C. § 1221(1)). The futures contracts at issue in *Corn Products*, moreover, represented no more than rights to obtain the raw material and could "easily be viewed as surrogates for the raw material itself" (2 B. Bittker, *supra*, ¶ 51.10.3, at 51-62). Shares of stock, by contrast, represent a bundle of rights associated with ownership of a company, some of which have no connection to maintaining an inventory of a particular raw material.

ness into a new area (*Schlumberger Technology Corp.* v. *United States*, 443 F.2d 1115 (5th Cir. 1971)).

The courts are also in disarray with respect to the *motive* that must underlie an acquisition of stock in order for the sale of that stock to generate an ordinary loss. Some courts have been satisfied as long as there is a dominant business purpose for the acquisition; such a motive has been found to exist, and has been held sufficient to make stock a non-capital asset, where the shares had been held for 44 years. See *Union Pacific R.R.* v. *United States*, 524 F.2d 1343 (Ct. Cl. 1975), cert. denied, 429 U.S. 827 (1976). But the existence of a business motivation—usually, but not invariably, determined on a subjective basis [24]—has not always been thought to be enough. The Tax Court, seeking to avoid the need to measure and compare different motives, has held in a reviewed decision that any substantial investment motive for acquiring an asset would cause it to be treated as a "capital asset," even if the taxpayer could show a dominant business motive. *W.W. Windle Co.* v. *Commissioner*, 65 T.C. 694 (1976), appeal dismissed, 550 F.2d 43 (1st Cir.), cert. denied, 431 U.S. 966 (1977). The Fourth Circuit has taken the same approach. *Wright* v. *Commissioner*, 756 F.2d 1039 (1985). Most recently, some courts, including the Tax Court in this case (Pet. App. B20-B21), have stated that any stock acquisition motivated by the purpose of protecting one's business reputation falls within the "*Corn Products* doctrine." Thus, where a taxpayer initially agreed to purchase stock in a foreign company as an

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[24] See *Agway, Inc.* v. *United States*, 524 F.2d at 1204 (suggesting that motive must be determined by examination of objective indicia).

investment, and later went ahead with the purchase even though it had since learned that the acquired company had severe financial difficulties, the stock was held to be a non-capital asset on the theory that failing to go through with the deal would have harmed the purchaser's business reputation as a supposedly astute investor. *Campbell Taggart, Inc.* v. *United States*, 744 F.2d 442, 451 (5th Cir. 1984).[25]

Regardless of its particular formulation, the "*Corn Products* doctrine" developed by the lower courts presents numerous difficulties. First and foremost, as discussed earlier, it requires that the statutory definition of "capital asset" be completely ignored. Instead, it establishes an array of tests for determining whether property is a "capital asset"—tests that are fundamentally at odds with the import of the parenthetical clause in Section 1221, which has remained in the statute undisturbed for 60 years. However the doctrine is articulated in a particular case, it is likely to produce non-capital-asset treatment in a variety of situations that bear no resemblance at all to *Corn Products* itself.

Second, "the *Corn Products* doctrine" illogically makes the capital-asset determination turn upon a false dichotomy. A "business purpose" and an "investment purpose" are ill-defined categories that are

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[25] After this Court, over dissents by Justices Harlan, Stewart and Blackmun, denied the government's petitions for certiorari in *Waterman* and *Steadman* (400 U.S. 869 (1970)), the Commissioner found it necessary to issue Revenue Rulings that reflected what appeared to be the then-prevailing body of opinion in the lower courts. See, *e.g.*, Rev. Rul. 75-13, 1975-1 C. B. 67 (dominant business motive), superseded by Rev. Rul. 78-94, 1978-1 C. B. 58 (stating that the Commissioner would follow *W.W. Windle Co.* v. *Commissioner, supra*).

not true alternatives. Clearly, both purposes may coexist in a given transaction.[26]

Third, the "*Corn Products* doctrine" turns on motives, which petitioner (Br. 12), following most of the decisions, suggests must be the *subjective* motivation of the taxpayer. The determination of such a motive is usually an "uncertain and difficult" task for the fact finder (*Woodward* v. *Commissioner*, 397 U.S. 572, 577 (1970)), particularly when two or more motives are present that must be weighed relative to

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[26] The commingling of "business" and "investment" purposes is perhaps most obvious in cases like *Campbell Taggart, Inc.* v. *United States*, 744 F.2d 442 (5th Cir. 1984), where stock was held to be a non-capital asset because it was acquired to protect the taxpayer's "business reputation." The taxpayer there was a holding company "whose sole activity [was] the acquisition of capital assets"; the court stated that expenses to protect corporate goodwill are deductible business expenses and concluded that the loss on the stock in question had been incurred "to protect [the taxpayer's] goodwill and reputation" as an acquirer of corporate securities (744 F.2d at 453-454). In such a situation, it is obviously impossible to segregate "business" from "investment" purposes. A holding company like the taxpayer in *Campbell Taggart*, or a conglomerate like the taxpayer here, is in the "business" of making "investments," and the business reputation it seeks to cultivate is that of an astute investor. That observation also points up the flaw in the reasoning of the Fifth Circuit in *Campbell Taggart* and of the Tax Court in this case. The fact that expenses relating to an asset are "business expenses" does not mean that the asset is therefore a non-capital asset. For example, if a taxpayer purchases property for use in a trade or business over a period of years, the cost cannot be deducted in full in the first year; rather, the deduction must be spread out over the useful life of the property, which is commonly referred to as "capitalizing" the cost. That has no bearing, however, on whether the property is a "capital asset"; the answer to that question is determined by Section 1221.

each other. And an inquiry into motives is particularly obscure in the case of corporate motives, since corporate action typically reflects decisions taken collectively by a number of individuals.

The result of a focus on subjective motive, moreover, is to make capital-asset treatment almost elective with the taxpayer. If the taxpayer has a gain and wishes to have his asset treated as a capital asset, there will be little basis for questioning his testimony that it was acquired primarily as an investment. Indeed, we are aware of no reported decision that has applied the "*Corn Products* doctrine" to require a taxpayer to report the *gain* from a sale of stock as an ordinary gain. On the other hand, if the taxpayer has a loss and wishes to have his asset treated as an ordinary asset, it may not be difficult for him to come up with a "business purpose" that will satisfy some variant of the "*Corn Products* doctrine." Thus, ironically, the doctrine developed by the lower courts in the name of *Corn Products* presents taxpayers with the opportunity to choose between ordinary and capital treatment—precisely the "loophole" that this Court in *Corn Products* was determined not to open (see 350 U.S. at 53-54).

The instant litigation well illustrates the uncertainty that the "*Corn Products* doctrine" has engendered. The doctrine is sufficiently open-ended that all of the following approaches to the sale of petitioner's 661,000 shares of Bank stock have emerged during this case: (1) petitioner initially, when it expected to make a profit on the sale of the Bank stock, believed, and so communicated to its stockholders, that all of the shares would be capital assets whose sale would give rise to capital gain (see Pet. App. B10); (2) when the Bank shares were in fact sold at a loss,

petitioner took the position that all of the shares were non-capital assets whose disposition gave rise to ordinary loss; (3) the Tax Court held that most of the shares acquired after the end of 1972 were ordinary assets, but that those acquired earlier were capital assets; (4) petitioner, on appeal, took the position that all of the shares acquired after July 30, 1971—the date of its divestment election—were ordinary assets; and (5) it is the government's view (see pages 46-47, *infra*), that, even under the "*Corn Products* doctrine," all of the shares should be categorized as capital assets. A doctrine as shapeless as this has "workability" (Pet. Br. 21) only in the sense that it can be easily manipulated, and it should be rejected in favor of the statutory language enacted by Congress.

2. From this amalgam of disparate approaches and tests, petitioner chooses the broadest formulation, and the one most favorable to it, as the theory that should be adopted by this Court as the true "*Corn Products* doctrine" (see Pet. Br. 43-48). Petitioner maintains that an asset should be "characterized as an ordinary, non-capital asset if the dominant or primary motive for its acquisition was business-related" (Br. 43). This theory presents in exaggerated form the conceptual difficulties, discussed above, that are common to all of the tributaries of the "*Corn Products* doctrine."

First, the clash between petitioner's version of the doctrine and the statutory language is particularly marked. The test proposed by petitioner would render most of the exceptions specified in Section 1221 entirely superfluous. If the mere existence of a primary business purpose for acquiring property suffices to take that property out of the definition of "capital asset," there was no need for Congress to have enacted

the specific exceptions for certain types of business property in Section 1221(1), (2), and (4). These types of property, on petitioner's theory, would already have been excluded by the general rule since their acquisition was business-related.

Second, petitioner's theory that its Bank stock was not a capital asset cannot be reconciled with an established line of authority governing the treatment of securities in another context. The courts have consistently held that a "trader"—one who buys and sells securities for his own account—is engaged in a "trade or business" within the meaning of the Internal Revenue Code. Just last Term the Court accorded this line of authority the express recognition that it had implicitly granted 50 years ago. See *Commissioner* v. *Groetzinger*, No. 85-1226 (Feb. 24, 1987), slip op. 5-6 & 11 n.13; *Snyder* v. *Commissioner*, 295 U.S. 134 (1935). It is also clear that the securities that a trader buys and sells are capital assets. See *Mirro-Dynamics Corp.* v. *United States*, 374 F.2d 14 (9th Cir.), cert. denied, 389 U.S. 896 (1967); *Commissioner* v. *Covington*, 120 F.2d 768 (5th Cir. 1941); *Adnee* v. *Commissioner*, 41 T.C. 40 (1963). Indeed, assuring that securities sold by a "trader" would be treated as capital assets, while securities sold by a "dealer" would be excluded under the inventory exception, was what prompted Congress to amend the inventory exception in 1934 to cover only "property held for sale *to customers* in the *ordinary* course of * * * trade or business" (emphasis added). See note 14, *supra*. This well-established structure, of course, is wholly inconsistent with petitioner's position here. If a trader is in a "trade or business," then the securities that he trades are surely acquired for a purpose related to that business. Hence, under peti-

tioner's view, those securities would presumably be non-capital assets, in defiance of the law as it actually exists.

3. In light of the chaos that has attended the lower courts' efforts to expound a judicial exception to the statutory definition of "capital asset," we believe it is important that this Court reaffirm the primacy of the specific definition provided by Congress in Section 1221.[27] The court of appeals correctly held that the

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[27] This is not to suggest that all of the decisions issued under the rubric of the "*Corn Products* doctrine" are equally misguided. Some cases that do not stray too far from the facts of *Corn Products* itself do not reach unreasonable results and theoretically could be followed without creating an amorphous doctrine like *Booth Newspapers* that quickly leads to untenable results. For example, *Western Wine & Liquor Co.* v. *Commissioner*, 18 T.C. 1090 (1952), seems to reflect the proposition that a short-term purchase of stock or other asset for the sole purpose of assuring an inventory supply should be treated the same as the corn futures in *Corn Products*—at least as long as the stock is held no longer than necessary to accomplish its business objective. See 18 T.C. at 1099. It may well be that, as a policy matter, it makes sense not to treat such a purchase as a capital transaction. In light of the total disarray that has descended upon the lower courts since *Booth Newspapers* established a judicial doctrine untethered to the statutory text, however, we believe that sensible administration of the tax laws requires future cases in this area to be resolved only by reference to the terms of the statute. We therefore believe that the statutory exception for "inventory" should not be expanded to include common stock—which, unlike a commodity futures contract, is not a surrogate for inventory—and we accordingly do not embrace the holding of *Western Wine*. See 18 T.C. at 1100 (Van Fossen, J., dissenting) (predicting that the divergence from the statutory language approved in *Western Wine* "will rise to plague the Court in future cases"). If it makes sense in policy terms to treat as an ordinary asset either common stock or another

statutory definition leaves no room for capital stock, other than stock held by a dealer, to be treated as anything but a "capital asset." We thus think it clear that, on the facts here, all of the shares sold by petitioner in 1975 were "capital assets" and that the loss on that sale was entirely a "capital loss." It should be noted, however, that even under the various formulations of the "*Corn Products* doctrine," which we urge the Court to reject, it is highly questionable whether any of petitioner's shares could be characterized as other than capital assets.

Nothing in the Tax Court's findings or in petitioner's brief provides any basis for concluding that petitioner has satisfied the *Booth Newspapers* requirement that the acquisition of the shares be "an integral and necessary act in the conduct of [its] existing business" (303 F.2d at 921). To the contrary, the Tax Court's findings show that the Bank was quite isolated from petitioner's existing businesses—furniture manufacturing, insurance, data processing and tire sales—and that the Bank, unlike petitioner's other subsidiaries, never interacted with it in synergistic fashion. See Pet. App. B7, B18-B19. Indeed, the Tax Court specifically stated that "[t]he bank was not an integral and necessary part of [petitioner's] business" (*id.* at B19).

Even under petitioner's version of the "*Corn Products* doctrine," which requires no more than a "dominant business motive" for a stock purchase, petitioner's argument on these facts is highly dubious. One of the primary motives identified by the Tax Court for petitioner's post-1972 acquisitions of Bank stock

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class of property used in a trade or business, Congress can act, as it did in 1938, 1942, and 1954, to add that specific class of business property to the list of statutory exceptions.

was that petitioner "was compelled to participate [in capital calls] if it wished to preserve its equity in the bank" (Pet. App. B10). If the shares in the Bank were originally purchased as an investment, as the Tax Court found that they were, it is not apparent why further purchases to protect or enhance that investment should be treated as having a business, rather than investment, purpose. In general, an asset acquired to preserve one's existing assets ought to assume the same character as the assets sought to be preserved—in this case, capital assets. Cf. *United States* v. *Generes*, 405 U.S. 93 (1972) (bad debt incurred to protect non-business investment is a non-business bad debt under Section 166(d)).[28] And, as noted earlier (see note 26, *supra*), even if the dominant motive for petitioner's acquisition of Bank stock was to preserve its business reputation (see Pet. App. B21), the fact that expenses to preserve goodwill may normally be deducted does not mean that stock acquired for that purpose is a non-capital asset.

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[28] Petitioner errs in invoking *Generes* (Br. 46-47) to support its contention that a "dominant motive test" should be employed to distinguish between business and non-business assets for purposes of Section 1221. The Court in *Generes* was required to distinguish between the business and non-business aspects of the taxpayer's investment because the statute involved there, covering bad-debt losses, explicitly distinguished between business and non-business bad debts. See I.R.C. § 166(d). If Section 1221 established a similar dichotomy between business and non-business assets, the aspect of *Generes* to which petitioner refers would be relevant. In fact, of course, Section 1221 does precisely the opposite; the parenthetical clause states that it makes no difference whether or not the asset is used in a trade or business.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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No. 86-751

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ARKANSAS BEST CORPORATION
AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ of Certiorari to
the United States Court of Appeals
for the Eighth Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

ARGUMENT

I. THE COMMISSIONER'S ATTEMPT TO OVERTURN *CORN PRODUCTS* AND ITS PROGENY IGNORES THE CONGRESSIONAL PURPOSE UNDERLYING 26 U.S.C. § 1221 AND, IF ACCEPTED, WOULD UNDERMINE OVER FIFTY YEARS OF RELIANCE UPON THAT PURPOSE

The Commissioner of Internal Revenue (the "Commissioner") asks this Court to ignore over fifty years of history, during which this Court, the lower courts, the Internal Revenue Service (the "Service") and Congress have consistently recognized the breadth of what is today known as the *Corn Products* doctrine. This doctrine provides that an asset acquired and held for a dominant business purpose is treated

as an ordinary asset, notwithstanding the literal language of the capital asset definition. Despite this history, the Commissioner now suggests that Congress never intended that stock purchased for a dominant business purpose be treated as an ordinary asset. In doing so, the Commissioner necessarily contends that every branch of the federal government — this Court, the lower Courts (except the Eighth Circuit Court of Appeals (the "Eighth Circuit")), the Service and Congress itself — consistently has misinterpreted not only this Court's decision in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) ("*Corn Products*"), but 26 U.S.C. § 1221[1] as well.

A. The Commissioner has Failed to Demonstrate that Congress Intended, or Intends, that Section 1221 be Interpreted Literally

Contrary to the Commissioner's argument, *see* Brief of Respondent on Writ of Certiorari at 18, *Arkansas Best Corporation and Subsidiaries v. Commissioner* (No. 86-751) ("Resp. Br."), Congress never intended to grant capital asset treatment to every category of asset not specified in one of the exclusions in § 1221. Neither the legislative history nor the express terms of § 1221 support the Commissioner's position.

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[1] Unless otherwise noted, Section references are to the Internal Revenue Code of 1954, as amended, except for references to "Section 117," which are references to the Internal Revenue Code of 1939, as amended.

1. The Legislative History of Section 1221 Establishes that Congress Intended to Distinguish between Investment Assets and Assets Acquired and Held for a Dominant Business Purpose

When Congress enacted § 206(a)(6) of the Revenue Act of 1921,[2] it distinguished for the first time between property "acquired and held by the taxpayer for profit and investment" and other property. Congress accorded a different treatment to property "acquired and held . . . for profit and investment" in order "to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." *Corn Products*, 350 U.S. at 51 (quoting *Burnet v. Harmel*, 287 U.S. 103, 106 (1932)). Although Congress deleted the qualitative "acquired and held . . . for profit and investment" language in 1924,[3] this Court noted subsequently that the 1921 provision had been "reenacted in 1924 without material change." *Burnet v. Harmel*, 287 U.S. 103, 106 (1932). The original intent of Congress, to provide special tax treatment for assets "acquired and held . . . for profit and investment," remained.

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[2] Section 206(a)(6), the original predecessor of § 117(a) of the Internal Revenue Code of 1939 and § 1221 of the Internal Revenue Code of 1954, provided as follows:

> The term "capital assets" as used in this section means *property acquired and held by the taxpayer for profit and investment for more than two years* (whether or not connected with his trade or business), but does not include property held for his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the end of the taxable year.

Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (1921) (emphasis added).

[3] *See* Revenue Act of 1924, ch. 234, § 208(a), 43 Stat. 253 (1924).

Consistently with that congressional purpose, both this Court[4] and the Treasury Department[5] (the "Treasury") have specifically recognized the determinative role of the tax-

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[4] *See Corn Products.*

[5] G.C.M. 17322, XV-2 C.B. 151 (1936) provided that since "hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets," gains and losses therefrom should be treated as ordinary business gains and losses. XV-2 C.B. at 155. The Treasury did not suggest that "hedges" fit within the literal language of a statutory exclusion, but instead looked at the business purpose for them.

Following this Court's adoption in *Corn Products*, 350 U.S. at 53, of the rationale of G.C.M. 17322 (at the Commissioner's insistence), the Service has applied the *Corn Products* doctrine in a variety of other situations as well. *See, e.g.*, Rev. Rul. 78-396, 1978-2 C.B. 114 (currency exchange produces ordinary loss where no investment intent for acquisition of currency); Rev. Rul. 78-94, 1978-1 C.B. 58 (sale of stock can give rise to ordinary income or loss if no substantial investment purpose for acquisition of stock; revoking Rev. Rul. 75-13); Rev. Rul. 75-13, 1975-1 C.B. 67 (sale of stock gives rise to ordinary income or loss if predominant purpose for acquiring asset is business-related); Rev. Rul. 72-238, 1972-1 C.B. 65 (gain realized by bank in foreclosure proceeding is ordinary income); Rev. Rul. 70-64, 1970-1 C.B. 36 (redemption of allocation notice provided by agricultural cooperative treated as ordinary income because member joined cooperative to facilitate its business); Rev. Rul. 58-40, 1958-1 C.B. 275 (stock purchased solely for purpose of securing inventory is an ordinary asset). In fact, the Service recognized that its arguments before this Court contradict its administrative position when, on September 29, 1987, in response to the granting of certiorari in this case, it suspended published revenue rulings that rely upon or apply the *Corn Products* doctrine. I.R.S. Notice 87-68, 1987-41 I.R.B. 1.

In addition, the Treasury specifically has noted in its own regulations that stock *can* be other than a capital asset. *See* Treas. Reg. §§ 1.907(c)-1(d)(1), (3) (stock may be classified as an "asset used in a trade or business" for purposes of § 907 only if not a

payer's purpose in classifying assets as capital or ordinary. All of the lower courts that have faced the issue (prior to the Eighth Circuit's unprecedented decision here) have followed suit.[6] No court ever held that Congress intended that the capital asset provision be interpreted literally in all circumstances.

In the face of this long-standing administrative practice under, and judicial interpretation of, the capital asset provision, Congress has not indicated any disagreement with the *Corn Products* doctrine, despite amending § 1221 three times since this Court rendered its decision in *Corn Products*.[7] This Court has stressed time and time again that congressional inaction in the face of consistent, long-standing administrative and judicial interpretations "bespeaks congressional approval." *Corn Products*, 350 U.S. at 53.[8] In fact, this Court found in *Corn Products*, at the Commissioner's insistence, that

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capital asset; regulation contemplates that stock acquired to ensure adequate inventory supply can be a non-capital asset).

[6] *See, e.g., Becker Warburg Paribas Group Inc. v. United States*, 514 F. Supp. 1273, 1280 (N.D. Ill. 1981) (seat on stock exchange held to facilitate floor trading was treated as ordinary asset); *see also* cases cited in Brief of Petitioner on Writ of Certiorari at 8 nn.5-6, *Arkansas Best Corporation and Subsidiaries v. Commissioner* (No. 86-751) ("Pet. Br.").

[7] *See* amendments cited in Brief of Petitioner on Petition for Writ of Certiorari at 3 n.1, *Arkansas Best Corporation and Subsidiaries v. Commissioner* (No. 86-751).

[8] *See also Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983); *Helvering v. Winmill*, 305 U.S. 79, 83 (1938); *Burnet v. Harmel*, 287 U.S. at 108. *Cf.* Rev. Rul. 75-533, 1975-2 C.B. 359, 360-61 (citing *Corn Products* as support for the proposition that the consistent administrative interpretation of Treas. Reg. § 20.2055-1 took on the "force of law" when Congress failed to amend the statute despite the long-standing interpretation thereof).

the business purpose principle established by G.C.M. 17322, XV-2 C.B. 151 (1936), was too entrenched to be changed. 350 U.S. at 53. Over thirty years later, it is the Commissioner who asks for change.

The Commissioner now suggests that "congressional silence" is not a reliable guide to congressional intent. *See* Resp. Br. at 24 n.16. But this Court need not rely upon congressional silence alone to conclude that Congress has sanctioned the *Corn Products* doctrine.[9] That conclusion also is compelled by express congressional consideration and ultimate rejection of the position asserted by the Commissioner in this case. *Cf. Commissioner v. Brown*, 380 U.S. 563, 578 (1965) (significant that Congress had considered, but rejected, a legislative response to a tax result criticized by the Treasury).

The 94th Congress specifically addressed the very question before this Court and declined to adopt a Treasury recommendation that all securities (except securities acquired by dealers and bonds acquired by banks) be considered capital assets. *See* Joint Committee on Internal Revenue Taxation, 94th Cong., 1st Sess., *Description of Technical and Minor Bills*

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[9] It is significant that Congress has not hesitated to act when it has disagreed with the courts' analysis of the capital asset provisions. *See, e.g., Helvering v. William Flaccus Oak Leather Co.*, 313 U.S. 247 (1941) (fire insurance proceeds treated as ordinary income; legislatively overturned by addition of the predecessor of § 1231(a)(3)(A)(ii)); *Watson v. Commissioner*, 197 F.2d 56 (9th Cir. 1952), *aff'd*, 345 U.S. 544 (1953) (gain attributed to unharvested crop treated as ordinary income; legislatively overturned by addition of the predecessor of § 1231(b)(4)); *Fairbanks v. United States*, 95 F.2d 794 (9th Cir. 1938), *aff'd*, 306 U.S. 436 (1939) (payment and discharge of bond not a sale or exchange; legislatively overturned by addition of the predecessor of § 1271(a)(1)). Yet Congress has never suggested that it disagrees with the *Corn Products* doctrine.

Listed for a Hearing by the Committee on Ways and Means on December 10, 1975 (December 9, 1975). The committees of both houses of Congress reviewed the current law, noting the continuing viability of the *Corn Products* doctrine.[10] Neither found the change proposed by the Treasury desirable.[11]

Congress repeatedly has sanctioned the *Corn Products* doctrine by reenacting § 1221 without material change, despite the universally accepted interpretation of that statute. Accordingly, it is not for the judiciary to change the long-established interpretation of § 1221. If change is desirable — and the Treasury's failure to persuade Congress to make such a change in 1975 casts doubt on that proposition — it should come from Congress.

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[10] *See* H.R. Rep. No. 1360, 94th Cong., 2d Sess. 3 (1976); S. Rep. No. 1392, 94th Cong., 2d Sess. 2-3 (1976). That both houses of Congress are clearly aware of the *Corn Products* doctrine and its implications was made obvious as recently as 1985 and 1986, when committees of each house noted:

> [H]owever, under *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), property that satisfies the literal language of section 1221 of the [Internal Revenue] Code is not considered a capital asset if the property is used by the taxpayer as an integral part of a trade or business.

H.R. Rep. No. 426, 99th Cong., lst Sess. 450 n.19 (1985); S. Rep. No. 313, 99th Cong., 2d Sess. 434 n.5 (1986).

[11] Although Arkansas Best's statement on page 38 of its opening brief that the Senate never approved the version of H.R. 10902, 94th Cong., 2d Sess. (1976) passed by the House of Representatives is technically correct, Arkansas Best wishes to note that the Senate did pass a slightly amended version of H.R. 10902, 122 Cong. Rec. 34,589, 34,664 (1976). Both bills would have required taxpayers to "mark" all securities not purchased as investments, and thus rejected the Treasury's proposal. Neither bill went to conference.

2. The Express Terms of Section 1221 do not Negate the Intent of Congress to Differentiate between Investment Assets and Business Assets

Contrary to the Commissioner's suggestion, *see* Resp. Br. at 18, the *Corn Products* doctrine does not render the express language of § 1221 irrelevant.[12] The Commissioner argues that if assets acquired and retained for a dominant business purpose are treated as ordinary assets, then the parenthetical contained in § 1221 — "(whether or not connected with his trade or business)" — is meaningless. The parenthetical, however, does not address the proper characterization of a particular asset, but states only that mere connection of an

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[12] The Commissioner also suggests that the *Corn Products* doctrine makes the five exclusions in § 1221 superfluous. *See* Resp. Br. at 21. But § 1221 must be evaluated in light of the entire Internal Revenue Code. *See, e.g., Burnet v. Harmel*, 287 U.S. 103 (bonus payments paid pursuant to oil and gas lease were ordinary income even though lease treated as transfer of real property interests under state law); *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958) (payment for transfer of rights to oil and gas payments was ordinary income even though such rights were property under state law). Like the "business purpose" and "continuity of interest" concepts in tax-free reorganizations, the *Corn Products* doctrine exists as a concept separate and distinct from the exclusions in § 1221. When an asset has been acquired and held for a dominant business purpose, the asset is an ordinary asset and the exclusions in § 1221 are not implicated.

Nor does the *Corn Products* doctrine render § 165(g)(3) superfluous. *See* Resp. Br. at 24 n.15. Section 165(g)(3) provides a safe harbor for parent corporations which own more than 80 percent of their subsidiaries. In the event that the stock of the subsidiary becomes worthless, such stock is accorded ordinary loss treatment under § 165(g)(3). Contrary to the Government's suggestion, *see* Resp. Br. at 24 n.15, § 165(g)(3) says nothing about the stock of a less than 80-percent owned subsidiary. Such stock must be analyzed under the *Corn Products* doctrine.

asset to a trade or business is not determinative of its status as capital or ordinary. Simply put, the statute recognizes that businesses can, and do, own capital assets connected with such businesses. *See, e.g., Crow v. Commissioner*, 79 T.C. 541 (1982) (discussion of "business capital assets").

But assets acquired by a taxpayer for a dominant business purpose are not, and were never intended to be, granted capital asset treatment under § 1221. As the Commissioner argued in his brief in *Corn Products*:

> Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments. The purpose is to protect "investment property" as distinguished from "stock in trade," or property bought and sold for a profit.

Brief of United States on Writ of Certiorari at 27-28, *Corn Products Refining Co. v. United States*, 350 U.S. 46 (1955) (No. 20). The parenthetical does not support the Commissioner's position that all securities must be treated as a capital asset, but rather refutes the existence of any flat or mechanical rule. The statute instead requires that the purposes for acquiring and holding a particular asset, even if connected to a trade or business, be analyzed when determining whether or not it is a capital asset.[13]

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[13] *See also* Brief of Commissioner on Petition for Writ of Certiorari at 17, *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958) (No. 921):

> [A]s the *Corn Products* case demonstrates, a transaction may fit the literal language of the statute and yet not qualify for capital

Moreover, this Court always has sought to interpret the revenue laws to ensure that congressional purpose will be achieved.[14] Literal application of § 1221 would provide preferential tax treatment to taxpayers in numerous circumstances not contemplated by Congress. It was this concern which this Court stressed in *Corn Products*:

> [T]he capital-asset provision of § [1221] must not be so broadly applied as to defeat rather than further the purpose of Congress . . . Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § [1221] applies to transactions in property which are not the normal source of business income. It was intended to "relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." . . . Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose.

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gain treatment where it does not fall within the obvious purpose of Congress and where a taxpayer would otherwise be able . . . "to transmute ordinary income into capital gain at will."

[14] *See, e.g.*, cases cited in Pet. Br. at 32 n.18. Similarly, the Service has acknowledged that the revenue laws should be interpreted in a non-literal fashion where necessary to effectuate congressional intent. *See* Rev. Rul. 79-404, 1979-2 C.B. 382 (citing *Corn Products*).

350 U.S. at 52. This Court will do no harm to the statute by implementing its very purpose.

B. Consistently with Congressional Purpose, this Court has Interpreted Section 1221 in a Non-Literal Fashion

This Court has confronted in numerous instances the broad definitional approach adopted by Congress in § 1221. In each instance, this Court has eschewed a literal interpretation where necessary to effectuate congressional intent. In *Burnet v. Harmel*, this Court determined that a lump-sum bonus payment to a lessor under an oil and gas lease was to be treated as ordinary income, even though there was a transfer of "property" to the lessee under state law.[15] 287 U.S. at 112. Seeing no reason to distinguish bonus payments from royalties, which extend over the life of the lease, *id.* at 112, this Court concluded that taxation of such payments as ordinary income did not produce "the kind of hardship aimed at by the capital gains provision of the taxing act." *Id.* at 106. Similarly, in *Hort v. Commissioner*, 313 U.S. 28 (1941), this Court ruled that a lump-sum payment for cancellation of a lease that had nine years to run was ordinary income to the lessor. Because the amount received was essentially a substitute for ordinary rental income, this Court ruled the payment must be regarded as ordinary income even though the leases constituted "property" which failed to come within an exclusion in § 117. *Id.* at 31. In both *Burnet v. Harmel* and *Hort*, the purpose of the statute prevailed, and a literal interpretation

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[15] *See also Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260 (1958) (lump-sum payment for transfer of rights to oil and gas payments was ordinary income even though under state law the transferred oil and gas payments were "property").

thereof, like that now advocated by the Commissioner, was rejected.

This Court later ruled in *Corn Products* that the taxpayer's sale of corn futures[16] produced ordinary income even though corn futures did not fall within the literal language of the exclusions of § 117(a). 350 U.S. at 53. Since the *Corn Products* decision, this Court has continued to construe the capital asset definition narrowly, and in a manner directly inconsistent with the Commissioner's current position. In *Commissioner v. Gillette Motor Transport*, 364 U.S. 130 (1960), this Court ruled that compensation received by the taxpayer for a temporary taking of its facilities during World War II was ordinary income, stating:

> While a capital asset is defined in § 117(a)(1) as "property held by the taxpayer," it is evident that not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset.

Id. at 134. Again, the congressional policy underlying § 1221 prevailed over a contradictory, literal interpretation of the statute.

Despite this Court's holdings to the contrary, the Commissioner now suggests that a literal approach to the statute is required. The Commissioner contends that this Court in *Corn*

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[16] The Commissioner attempts unsuccessfully to distinguish "corn futures" from stock acquired for the purpose of securing adequate inventory supply. *See* Resp. Br. at 38 n.23. Both corn futures and stock are intangible assets, providing rights to other assets. Neither are, in any sense, inventory, but both may be purchased for the business purpose of ensuring an adequate inventory supply. It is this business purpose which mandates ordinary asset treatment under § 1221.

Products did not create a judicial exception to § 117(a) in recognition of congressional purpose, but merely "interpreted" the literal terms of the inventory exclusions under § 117(a). *See* Resp. Br. at 30.[17] The Commissioner's current contentions flatly contradict the arguments which he presented to this Court in *Corn Products*,[18] as well as this Court's analysis in that case. No amount of "re-interpretation" by the Commissioner of this Court's decision can alter the simple truth that this Court has never insisted that § 1221 be applied literally in all cases, and that the Commissioner's position in this case is utterly without precedent or congressional sanction.

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[17] This reading contradicts the Service's understanding of that decision in Rev. Rul. 82-204, 1982-2 C.B. 192, in which the Service acknowledged that *Corn Products* created an extra-statutory exception to § 1221. *See also* Rev. Rul. 79-404, 1979-2 C.B. 382 (nonliteral interpretation of § 1221 necessary to effectuate congressional intent); Treasury Regulations and Revenue Rulings cited *supra* note 5.

[18] The relevant Question Presented in *Corn Products*, as stated by the Commissioner, was as follows:

> Whether the Court of Appeals was correct in affirming the holding of the Tax Court that purchases and sales by taxpayer of corn futures on commodity exchanges were consummated in order to obtain protection for its manufacturing business and were comparable to hedges, and hence that such transactions resulted in ordinary, rather than capital, gains and losses within the purview of the Internal Code of 1939.

Brief of United States on Petition for Writ of Certiorari at 2, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955) (No. 20). Thus, the Commissioner clearly asked this Court to consider the purpose for which the hedges were purchased, not whether such futures were in some sense "inventory."

C. The Lower Courts Consistently have Held that it is the Purpose for which an Asset is Acquired and Held that Determines Whether an Asset is a Capital or an Ordinary Asset

The Commissioner argues that Congress could not have sanctioned the *Corn Products* doctrine because no definable *Corn Products* doctrine exists. *See* Resp. Br. at 36.[19] This argument mischaracterizes the debate in the lower courts. That debate does not question the validity of the *Corn Products* doctrine, but only the precise evidentiary standard to be applied in assessing the taxpayer's motive.

The lower courts, except for the Eighth Circuit, consistently have applied the basic premise of *Corn Products* — that it is the purpose for which an asset is acquired and held, and not the nature of the asset, that is determinative under § 1221.[20] All of these courts agree that, at a minimum, the taxpayer must show that the *dominant purpose* for *acquiring and retaining* the asset was a business purpose. *See, e.g., Booth Newspapers, Inc. v. United States*, 303 F.2d 916 (Ct. Cl. 1962). While some courts have gone further to require that the taxpayer also prove the absence of a substantial investment purpose for the acquisition and retention of an asset, *see, e.g., W. W. Windle Co. v. Commissioner*, 65 T.C. 694, 713 (1976), *appeal dismissed for lack of jurisdiction*, 550 F.2d 43 (lst Cir.),

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[19] The Commissioner also erroneously suggests that disarray exists because of the unprincipled expansion of *Corn Products* beyond its factual limitations. *See* Resp. Br. at 37. The *Corn Products* decision requires an evaluation of purpose. Factual determinations must therefore be made, and those determinations, not surprisingly, produce an "amalgam" of results, reflecting the variety of factual situations which trial courts face in implementing congressional policy under § 1221.

[20] *See* cases cited *supra* note 6.

cert. denied, 431 U.S. 966 (1977), none has ever expressed disagreement with the basic premise of *Corn Products*.

It is significant that, notwithstanding this limited debate regarding the precise evidentiary standard applicable (which can be definitively resolved by the Court's decision in this case), all of these lower courts necessarily would agree that the National Bank of Commerce (the "Bank") stock purchased by Arkansas Best after 1972 was an ordinary asset. The Tax Court found that Arkansas Best purchased and held the post-1972 stock "exclusively for business purposes," *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 83 T.C. 640, 656 (1984), and that Arkansas Best "carried through on a losing proposition solely to preserve its business reputation," *id.* at 656-57.[21] These undisturbed factual findings would satisfy *any* standard adopted by the lower courts, and the

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[21] The Commissioner suggests that the quoted statements of the Tax Court conflict with its subsidiary finding that Arkansas Best purchased the Bank stock to preserve its equity in the Bank. *See* Resp. Br. at 11. The Commissioner confuses the issue by failing to read the Tax Court's subsidiary finding in context. First, the Tax Court clearly applied the "substantial investment standard" of *W. W. Windle Co.*, 65 T.C. at 710, so it necessarily concluded that any investment purpose which may have existed for the post-1972 purchases was not substantial. *See* 83 T.C. at 653. Second, the Tax Court found that Arkansas Best was "preserving its equity" only after finding that the condition of the Bank was critical, that the failure of Arkansas Best to participate in the capital calls would have resulted in the demise of the Bank, that Arkansas Best, as controlling shareholder of the Bank, had a special responsibility to the minority shareholders of the Bank, and that failure of the Bank would have damaged Arkansas Best's sources of financing and business reputation. Arkansas Best thus attempted to "preserve its equity," but only in the context of preventing the demise of the Bank, and thereby preventing possible litigation by minority shareholders and preserving Arkansas Best's business reputation. *See* 83 T.C. at 656.

debate among those courts as to "mixed motive" situations is irrelevant to the issues with respect to the post-1972 stock presented in this case.

D. The *Corn Products* Doctrine has Proved to be a Workable and Logical Implementation of Congressional Intent

Contrary to the suggestion of both the Eighth Circuit[22] and the Commissioner, *see* Resp. Br. at 36, the *Corn Products* doctrine has proved to be a workable and logical implementation of congressional intent, and does not allow taxpayers to "pick and choose" their tax consequences. While it is correct that asset acquisitions are sometimes driven by both business and investment reasons, *see* Resp. Br. at 40-41 & n.26, the Commissioner goes too far when he suggests that the *Corn Products* doctrine facilitates tax manipulation. This mischaracterization results from the Commissioner's understatement of the standard which the taxpayer must meet under *Corn Products*. As interpreted by the lower courts, the *Corn Products* doctrine requires the taxpayer to establish, at a minimum, that he *acquired and retained* the asset with a *dominant* business purpose if that asset is to be characterized as ordinary. No court has suggested, as the Commissioner now does, *see, e.g.*, Resp. Br. at 42, that any business connection, no matter how limited or attenuated, will suffice.[23]

Moreover, that the inquiry is one as to the taxpayer's purpose does not suggest that Congress could not have intended to sanction the *Corn Products* doctrine. Congress

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[22] *Arkansas Best Corporation and Subsidiaries v. Commissoner*, 800 F.2d 215, 221 (8th Cir. 1986)

[23] Contrary to the Commissioner's suggestion, taxpayers can, and do, lose cases involving asserted business losses under the *Corn Products* doctrine. *See* cases cited in Pet. Br. at 26.

has expressly provided subjective standards throughout the Internal Revenue Code.[24] Similarly, Congress has reenacted statutory provisions without material change despite subjective standards supplied by courts, where such standards were helpful in effectuating congressional intent.[25] Congress could choose to provide a bright-line standard under § 1221 to replace the *Corn Products* doctrine,[26] but it has chosen not to do so because of the difficulty of drafting a statute which can categorize an asset consistently with congressional intent in all factual situations. *See* Surrey, *Definitional Problems in Capital Gains Taxation*, 69 Harv. L. Rev. 985 (1956).

II. THE STOCK ACQUIRED BY ARKANSAS BEST AFTER IT FILED THE IRREVOCABLE NOTICE OF INTENT TO DIVEST IS PROPERLY TREATED AS AN ORDINARY ASSET

The Commissioner argues that, even if this Court reverses the decision of the Eighth Circuit, the stock purchased by Arkansas Best after 1972 does not qualify as an ordinary asset. *See* Resp. Br. at 46. This argument confuses the business of Arkansas Best with the businesses of its subsidiaries. Moreover, it ignores the Tax Court's undisturbed factual findings that Arkansas Best purchased and held the Bank stock "exclusively for business purposes," 83 T.C. at 656, and that Arkan-

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[24] *See, e.g.*, § 269 (acquisitions made to evade or avoid income tax); § 532 (accumulated earnings tax if earnings retained to avoid income tax). *See also* §§ 269A, 341, 357(b), 845, 877, 1221(1), 2107.

[25] *See* cases cited *supra* note 14.

[26] *See, e.g.*, § 2035 (moved to a flat three-year rule away from the subjective standard of whether a gift was given in contemplation of death).

sas Best "carried through on a losing proposition solely to preserve its business reputation," *id.* at 656-57.

The Commissioner contends that the post-1972 purchases of Bank stock were not "integral and necessary" acts in the conduct of Arkansas Best's existing business, claiming that the Bank was isolated from what the Commissioner viewed as Arkansas Best's businesses (trucking, furniture manufacturing, insurance, data processing and tire sales), that the Bank did not interact with Arkansas Best or its subsidiaries in a "synergistic" fashion, and that Arkansas Best did not provide management services to the Bank. *See* Resp. Br. at 46. In so arguing, the Commissioner improperly focuses upon the businesses of Arkansas Best's subsidiaries, rather than the business of Arkansas Best itself. The Tax Court found that Arkansas Best was in the business of acquiring and managing going concerns in diverse, yet complementary, lines of business. 83 T.C. at 653. The Tax Court further found that the post-1972 purchases were necessary to protect Arkansas Best from potential litigation and to preserve Arkansas Best's sources of financing and business reputation, factors critical to Arkansas Best's business as a holding company. It has long been settled that expenses incurred to protect business reputation are deductible as ordinary and necessary business expenses. *See Dunn & McCarthy, Inc. v. Commissioner*, 139 F.2d 242 (2d Cir. 1943). Assets acquired for the same business purpose likewise should be accorded ordinary asset treatment. *See Campbell Taggart, Inc. v. United States*, 744 F.2d 442 (5th Cir. 1984). Thus, even if the *Corn Products* doctrine did include an "integral and necessary" component, the post-1972 stock purchases would satisfy that test because they were necessary to protect Arkansas Best from possible litigation and to preserve its sources of financing and its reputa-

tion for skilled management. As such, the stock was an ordinary asset.[27]

Certain factual issues remain to be resolved, however, with regard to the Bank stock purchased by Arkansas Best between August 1, 1971 and January 1, 1973. As in the examples cited by the Service in Rev. Rul. 58-40, 1958-1 C.B. 275, Arkansas Best intended to sell the stock it purchased in 1972 before it even acquired it, and did not retain the stock longer than necessary. *See also Campbell Taggart, Inc.*, 744 F.2d 442. The Tax Court clearly erred when it distinguished the pre-1973 stock purchases from the stock purchased by Arkansas Best after 1972.[28] The Eighth Circuit denied Arkansas Best's challenge to this factual finding, not because the evidence supported the Tax Court's finding, but because the Eighth Circuit erroneously believed that stock could never be an ordinary asset under any circumstances.[29] Consequently, Arkansas Best's contention that the Tax Court's factual finding was clearly erroneous effectively has not been reviewed.

Given the Tax Court's largely uncontested findings of fact, it is only the stock that was purchased between August 1, 1971 and January 1, 1973 that can be considered subject to

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[27] Similarly, the stock purchased by Arkansas Best from its subsidiary, Universal Insurance Company, was purchased for dominant business reasons. The Commissioner concedes that the assumption underlying the Tax Court's decision with regard to this stock was erroneous. *See* Resp. Br. at 9 n.5. Thus, there is no factual dispute about this stock, and it also should be accorded ordinary asset treatment.

[28] It should be noted that the Tax Court did not have the benefit of the analysis of the Fifth Circuit Court of Appeals in *Campbell Taggart, Inc.*, 744 F.2d 442, when it rendered its decision in this case.

[29] 800 F.2d at 221.

the "mixed motive" controversy which has existed in the lower courts. Arkansas Best asks this Court to apply the dominant motivation test previously applied by this Court in the context of §§ 165 and 166. *See, e.g., United States v. Generes*, 405 U.S. 93, 103 (1972).[30]

CONCLUSION

In light of the Eighth Circuit's erroneous rejection of the *Corn Products* doctrine, its decision should be reversed and rendered as to the post-1972 stock, and reversed and remanded as to the stock acquired during the period of late 1971 through 1972.

Respectfully submitted,

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[30] The Commissioner errs when he argues that the *Generes* standard may not be applied in this case because the business/non-business distinction is of no import under § 1221. That the business/non-business distinction is explicit in § 166, but implicit in § 1221, does not suggest that different standards should apply.

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No. 86-751

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF THE NATIONAL COUNCIL OF FARMER COOPERATIVES AS AMICUS CURIAE

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF OF THE NATIONAL COUNCIL OF FARMER COOPERATIVES AS AMICUS CURIAE

INTEREST OF THE NATIONAL COUNCIL OF FARMER COOPERATIVES

The National Council of Farmer Cooperatives ("NCFC"), with the consent of the parties,[1] submits this Brief as *Amicus Curiae* in support of Appellant's position that the United States Court of Appeals for the Eighth Circuit was in error when it held that capital stock must always be treated as a capital asset without regard to the reasons the stock was purchased and held.[2]

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[1] Copies of our letters to counsel for the parties to this case requesting their permission to file an *amicus* brief and their favorable responses accompanied this brief when filed.

[2] *Arkansas Best Corporation* v. *Commissioner*, 800 F.2d 215 (8th Cir. 1986) rev'g. in part and aff'g. in part 83 T.C. 640 (1984).

(footnote continued on next page)

The NCFC is a nationwide association of businesses operated on a cooperative basis which are owned and controlled by farmers. Its membership includes 90 major marketing and farm supply cooperatives, the 37 banks of the Farm Credit System,[3] and 33 state councils of farmer cooperatives. The members of the NCFC handle nearly every type of agricultural commodity produced in the United States, market these commodities domestically and around the world and furnish production supplies and credit to their farmer members and patrons. The membership of the members of NCFC includes approximately 90 percent of the nearly 5,600 local farmer cooperatives in the nation.

Farmer cooperatives were formed, and operate today, to meet the needs of farmers for reliable and fairly-priced sources for farm supplies (such as, fertilizer, seed, feed and pesticides) and farm services and to provide farmers assistance in effectively marketing the commodities that they produce. These cooperatives are an integral extension of the farming operations of their members. Their importance to agriculture is demonstrated by the fact that five out of six American farmers are affiliated with one or more cooperatives.

What distinguishes cooperatives from other businesses is that a cooperative's earnings inure directly to the benefit of its patrons, not to its shareholders. Cooperatives distribute their earnings each year in the form of patronage dividends based upon the quantity or value of business done with or for each patron.

(footnote continued from preceding page)

The only exception recognized by the Eighth Circuit was for security dealers holding capital stock in inventory who are subject to the rules of Code section 1236.

[3]The Farm Credit System consists of the 12 district Federal Land Banks, the 12 district Federal Intermediate Credit Banks, the 12 district Banks for Cooperatives and the Central Bank for Cooperatives all of which are Federally chartered and governed by the Farm Credit Act and the Farm Credit Administration.

Farmer cooperatives are incorporated and issue capital stock to their members. However, that stock does not represent an "investment" by their members as that term is commonly used. Normally, cooperative stock is entitled to no dividends. As noted, earnings of a cooperative are distributed on the basis of patronage, not stock ownership. Usually, cooperative stock has no appreciation potential since it is sold at par and is entitled upon liquidation to receive an amount equal to its par value and no more. Residual assets on liquidation normally are distributed on a patronage basis. In most cases, cooperative stock is subject to restrictions on transferability and there is no market for the stock. Usually, members are required to buy stock in a cooperative before they can patronize the cooperative. They may receive additional shares of capital stock as a portion of their patronage dividends. Given the characteristics of cooperative stock and the conditions under which members obtain it, it is clear that members acquire and hold the stock for business, not investment, purposes.

The Internal Revenue Service has publicly recognized the unique features of the stock of cooperatives. *Rev. Rul. 78-402*, 1978-2 Cum. Bull. 138, held that stock purchased by a retailer in a cooperative wholesaler "was purchased and held predominantly for purposes related to the conduct of the . . . [retailer's] business, and not predominantly, for investment purposes." The ruling stated:

> ". . . the purchase and holding of the common stock of the cooperative by **X** was predominantly related to the conduct of the . . . [retailer's] business since it permitted **X** to avail itself of the cooperative's purchasing power, supply of products, and business services. In addition, no dividends were payable with respect to the stock, and because the cooperative stock was purchased at par and redeemable at the lower of par or book value, the optimum return **X** could expect to receive upon its redemption was the par value purchase price."

1978-2 Cum. Bull. 138, at 138-9.

Recently in *Ltr. 8713055* (December 30, 1986),[4] the Internal Revenue Service cited *Rev. Rul. 78-402* and contrasted the facts in that ruling with the Eighth Circuit decision in *Arkansas Best.*

Many cooperatives pay a portion of their patronage dividends each year in the form of written notices of allocation that inform each member that earnings have been allocated to the member on the books of the cooperative. The Internal Revenue Service has ruled that such notices are the equivalent of equity. *Rev. Rul. 69-216*, 1969-1 Cum. Bull. 109 and *Rev. Rul. 70-298*, 1970-1 Cum. Bull. 82. Provided certain formalities are followed, pursuant to Subchapter T (26 U.S.C. §§ 1381-1388) of the Internal Revenue Code of 1986 (hereinafter referred to as "Code") a cooperative is entitled to exclude from its income patronage dividends paid to members in this form, and members are required to include the notices in ordinary income at the face amount (without regard to fair market value). Usually the notices have no dividend rights or appreciation potential.

Rev. Rul. 70-64, 1970-1 Cum. Bull. 36, held that a chicken farmer recognized an ordinary loss when a cooperative redeemed notices of allocation at less than face which had been distributed to the farmer as part of his patronage dividend from the cooperative. The ruling stated:

> "In the instant situation the taxpayer joined the cooperative to facilitate his business and to make it more profitable. The transaction that gave rise to the issuance of the notice of allocation arose in the ordinary course of taxpayer's trade or business. Accordingly, the loss incurred by the taxpayer upon redemption of the qualified written notice of allocation is an ordinary loss

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[4] Pursuant to section 6110(j)(3) of the Internal Revenue Code of 1986 (26 U.S.C. § 6110(j)(3)), private letter rulings may not be used or cited as precedent. This private letter ruling is cited solely as evidence of administrative acceptance of the special status of cooperative stock.

> deductible for 1968 under the provisions of section 165 of the Code. See *Corn Products Refining Company* v. *Commissioner*, 350 U.S. 46 (1955), Ct. D. 1787, C.B. 1955-2, 511; *Burnet* v. *Harmel*, 287 U.S. 103 (1932), Ct. D. 611, C.B. XI-2, 210; and *Western Wine and Liquor Company* v. *Commissioner*, 18 T.C. 1090 (1952), acquiescence, C.B. 1958-1, 6. The loss is measured by the difference between the stated amount included in income in 1963 and the amount received upon redemption."

1970-1 Cum. Bull. 36, at 36.

Rev. Rul. 70-407, 1970-2 Cum. Bull. 52, held that a cotton farmer incurred an ordinary loss when, in order to recoup a loss which it had incurred, a cooperative cancelled marketing credits that had been issued to the cotton farmer in prior years.

Because of the severely depressed state of American agriculture, many farmer cooperatives have incurred losses in recent years. The decision of the United States Court of Appeals for the Eighth Circuit in *Arkansas Best* is of great concern to the farmer cooperatives and their members represented by the NCFC because it is directly contrary to the present accepted treatment of capital stock issued by cooperatives. The NCFC's members are most concerned with the Eighth Circuit's conclusion that Arkansas Best was not entitled to ordinary loss treatment on the disposition of its stock "regardless of when or why the stock was acquired" (800 F.2d 215, at 220) and, with its statement that "we do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221." at 221. These conclusions suggest that losses of cooperatives and their members on capital stock (and perhaps written notices of allocation) constitute capital losses whether the stock was purchased to obtain, through the cooperative, a source of supply or a market for products or whether the stock (or notices of allocation) was received as a patronage refund on which the patron was taxed as ordinary income upon receipt. For

reasons set forth herein, the NCFC strongly believes that the conclusions of the Eighth Circuit are erroneous.

SUMMARY OF ARGUMENT

In its opinion in this case, the Eighth Circuit indicated that it believed the decisions of this Court in *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46, 100 L.Ed. 29, 76 S.Ct. 20 (1955), and of the courts that have since followed *Corn Products* to be "misbegotten." Declining to follow the lead of other courts, the Eighth Circuit announced that Code section 1221 should be read literally and that capital stock is always a capital asset.[5]

It is respectfully submitted that these views are in error. The *Corn Products* decision was not "misbegotten." It has its roots in a long line of decisions of this Court which hold that the capital gains and losses provisions of the tax laws are to be strictly construed. This Court has so held because these provisions are exceptions to the general rule that income and loss is ordinary. The *Corn Products* decision has roots as well in another long line of decisions of this Court that hold statutes (and in particular the Code) should be construed to achieve the purpose of Congress. Moreover, this Court decided *Corn Products* upon the urging of the Government and in so doing confirmed the correctness of prior administrative practice and a number of lower court decisions.

The *Corn Products* decision is a sensible and practical approach to construing the Internal Revenue Code and, until the recent decision of the Eighth Circuit, had been accepted by the Internal Revenue Service, the courts and Congress. Decisions such as *Corn Products*, which are grounded on construing statutes based on their purpose, are essential to the proper functioning of the Federal tax system.

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[5] As noted above, the only exception recognized by the Eighth Circuit was for securities dealers holding capital stock in inventory who are subject to the rules of Code section 1236.

There is no support for the position taken by the Eighth Circuit that this Court overuled *Corn Products* by its decision in *United States* v. *Mississippi Chemical Corporation*, 405 U.S. 298, 31 L.Ed.2d 217, 92 S.Ct. 908 (1972). The Eighth Circuit attributes considerably more weight than it deserves to a reference to Code section 1221 in *Mississippi Chemical*. The authorities cited in that reference dealt only with the question of whether the amounts in issue were currently deductible or should be capitalized. The question of whether the expenditure produced a Code section 1221 "capital asset" was not at issue.

ARGUMENT

I. Corn Products and its Progeny Are Not "Misbegotten."

The Eighth Circuit's opinion asserts that "*Corn Products* and its progeny" are "misbegotten" and calls for a literal construction of Code section 1221:

> ". . . We do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under section 1221. It seems to us that one of the last places where the legal system deliberately should foster subjectivity and uncertainty is in the tax code. *Corn Products* and its progeny, which we respectfully view as misbegotten, have done precisely that, leading to increased recourse to the administrative and judicial processes to resolve conflicting contentions about taxpayers' motivations in purchasing capital stock. Congress could have written section 1221 to incorporate some sort of exception regarding capital stock, just as it recognized the unique position of securities dealers in 26 U.S.C. § 1236, but it did not do so. We believe that the judiciary lacks authority to create exceptions to section 1221 that Congress did not choose to make."

800 F.2d 215, at 221.

Corn Products is not "misbegotten." It is rooted in two long lines of cases decided by this Court, one holding that the capital gains provisions should be construed narrowly and the other holding that literal compliance with the tax statutes is not sufficient if the purpose is not met.

A. This Court has consistently held that the capital asset provisions (including the term "capital asset") should be construed narrowly.

Capital gains have been accorded special treatment for Federal income tax purposes since the Revenue Act of 1921, ch. 136, 42 Stat. 227. Since *Renziehausen* v. *Lucas*, 280 U.S. 387, 74 L.Ed. 501, 50 S.Ct. 156 (1930), this Court has construed the capital gains provisions narrowly. This Court has done so by narrowly construing the term "capital asset" and also by narrowly construing the term "sale or exchange".

In *Renziehausen*, this Court held that a distiller realized ordinary income upon the sale of whiskey which had been segregated from the raw whiskey sold in the normal course of the distiller's trade or business to mature over a period of years. The whiskey was carried in a separate account entitled "Old Whiskey" in the distiller's records. This Court affirmed the holding of the lower courts that "the whiskey was clearly part of the stock in trade." 280 U.S. 387, at 389.

In *Burnet* v. *Harmel*, 287 U.S. 103, 77 L.Ed. 199, 53 S.Ct. 74 (1932), this Court held that bonus payments and royalties received by the owner of Texas oil lands for oil and gas leases constituted ordinary income. Although under Texas law the lease passed title to the oil and gas in place to the lessee and there was no specific statutory exception to capital gains treatment for oil and gas leases, this Court did not believe it would be consistent with the purpose of Congress in providing special tax treatment for sales of capital assets to treat the payments as capital:

> "Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other

> income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, reënacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions."

287 U.S. 103, at 106.

This Court concluded that treating gain as capital "would have tended to defeat rather than further the purpose of the Act." 287 U.S. 103, at 108.

In *Fairbanks* v. *United States*, 306 U.S. 436, 83 L.Ed. 855, 59 S.Ct. 607 (1939), this Court affirmed administrative practice and the lower courts when it held that gain realized upon the redemption of bonds did not result in a "capital gain" because "payment and discharge of a bond is neither sale nor exchange within the commonly accepted meaning of the words." 306 U.S. 436, at 437. By the time this Court rendered its decision, the statute had been amended for 1934 and later years by adding what is now Code section 1271(a)(1) to provide capital gains treatment for redemptions. This and other examples of the interplay between court decisions and Congressional actions listed below illustrate how Congress has monitored court decisions in this area. Where Congress has felt that changes are required, it has acted.

In *Hort* v. *Commissioner*, 313 U.S. 28, 85 L.Ed. 1168, 61 S.Ct. 757 (1941), this Court held that a lump sum payment for cancellation of a lease that had nine years to run was ordinary income to the lessor. This Court accepted Hort's characterization of the lease as "property" but did not feel

compelled to treat the cancellation payment as capital simply because there was no explicit statutory exception for lease cancellation payments:

> "Simply because the lease was 'property' the amount received for its cancellation was not a return of capital, quite apart from the fact that 'property' and 'capital' are not necessarily synonymous in the Revenue Act of 1932 or in common usage. Where, as in this case, the disputed amount was essentially a substitute for rental payments which § 22(a) expressly characterizes as gross income, it must be regarded as ordinary income, and it is immaterial that for some purposes the contract creating the right to such payments may be treated as 'property' or 'capital'."

313 U.S. 28, at 31.

In 1954, Congress added what is now Code section 1241 to treat payments made to a lessee for cancellation of a favorable lease as capital gain, but left the result in *Hort* unchanged.

In *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247, 85 L.Ed. 1310, 61 S.Ct. 878 (1941), this Court held that insurance proceeds received by a corporation as compensation for the loss by fire of buildings, machinery and equipment were ordinary income because there was no "sale or exchange." This result was changed by Congress in 1942 with the addition of what is now Code section 1231(a)(3)(A)(ii).

In *Kieselbach* v. *Commissioner*, 317 U.S. 399, 87 L.Ed. 358, 63 S.Ct. 303 (1943), this Court held that a portion of the proceeds received from the condemnation by the City of New York of land was ordinary income since the portion was "paid to the taxpayers in lieu of what they might have earned on the sum found to be the value of the property on

the day the property was taken." 317 U.S. 399, at 403. This Court then stated:

> "... petitioner contends that as just compensation requires the payment of these sums for delay in settlement, they are a part of the damages awarded for the property. But these payments are indemnification for delay, not a part of the sale price. While without their payment just compensation would not be received by the vendor, it does not follow that the additional payments are a part of the sale price under § 117(a) [the predecessor to Code section 1221]. The just compensation constitutionally required is not the same thing as the sale price of a capital asset."

317 U.S. 399, at 404.

In *Watson* v. *Commissioner*, 345 U.S. 544, 97 L.Ed. 1232, 73 S.Ct. 848 (1953), this Court held that a portion of the proceeds received from the sale of an orange grove should be allocated to the growing crop and treated as ordinary income. Responding to decisions of lower courts on this issue, in 1951 Congress amended the statute by adding what is now Code section 1231(b)(4) to make it clear that gain attributable to unharvested crops in circumstances similar to those in *Watson* was capital.

The next decision in this line is *Corn Products Refining Co.* v. *Commissioner*, *supra*. In *Corn Products*, this Court summarized the holdings of some of its prior decisions regarding the definition of capital assets as follows:

> "But the capital-asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. *Burnet* v. *Harmel*, 287 U.S. 103, 108. Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended 'to

> relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' *Burnet* v. *Harmel*, 287 U.S., at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term 'capital assets' in § 117. See *Hort* v. *Commissioner*, 313 U.S. 28, 31; *Kieselbach* v. *Commissioner*, 317 U.S. 399, 403."

350 U.S. 46, at 52.

Subsequent cases have reaffirmed the approach taken by this Court to the construction of the capital asset definitions contained in the tax laws. In *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260, 2 L.Ed.2d 743, 78 S.Ct. 691 (1958), this Court held that payments for oil and gas rights and sulphur rights were ordinary income even though under Texas law oil payments are interests in land. This Court held:

> "The purpose of § 117 was 'to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' See *Burnet* v. *Harmel*, 287 U.S. 103, 106. And this exception has always been narrowly construed so as to protect the revenue against artful devices. See *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46, 52.
>
> We do not see here any conversion of a capital investment . . .
>
> * * *
>
> These arrangements seem to us transparent devices. Their forms do not control. Their essence is determined

not by subtleties of draftsmanship but by their total effect."

356 U.S. 260, at 265 and 266-267.

In *Commissioner* v. *Gillette Motor Transport*, 364 U.S. 130, 4 L.Ed.2d 1617, 80 S.Ct. 1497 (1960), this Court held that compensation received by the taxpayer for a temporary taking of its facilities during World War II was ordinary income. This Court stated:

> "While a capital asset is defined in § 117(a)(1) as 'property held by the taxpayer,' it is evident that not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset. This Court has long held that the term 'capital asset' is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year. *Burnet* v. *Harmel*, 287 U.S. 103, 106. Thus the Court has held that an unexpired lease, *Hort* v. *Commissioner*, 313 U.S. 28, corn futures, *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, and oil payment rights, *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260, are not capital assets even though they are concededly 'property' interests in the ordinary sense. And see, Surrey, Definitional Problems in Capital Gains Taxation, 69 Harv. L. Rev. 985, 987-989 and Note 7.
>
> In the present case, respondent's right to use its transportation facilities was held to be a valuable property right compensable under the requirements of the Fifth Amendment. However, that right was not a capital asset within the meaning of §§ 117(a)(1) and 117(j)."

364 U.S. 130, at 134-135.

In *United States* v. *Midland-Ross Corp.*, 381 U.S. 54, 14 L.Ed.2d 214, 85 S.Ct. 1308 (1965), this Court held that original issue discount was ordinary income even though "original issue discount becomes property when the obligation falls due or is liquidated prior to maturity and § 117(a)(1) defined a capital asset as 'property held by the taxpayer,' . . ." 381 U.S. 54, at 56. This Court quoted from the passage in *Gillette Motor* set forth above and then stated:

> "In applying this principle, this Court has consistently construed 'capital asset' to exclude property representing income items or accretions to the value of a capital asset themselves properly attributable to income."

381 U.S. 54, at 57.

Congress has since essentially codified the holding of *Midland-Ross* in sections 1271 to 1288 of the Code.

Finally, in *Malat* v. *Riddell*, 383 U.S. 569, 16 L.Ed.2d 102, 86 S.Ct. 1030 (1966), this Court provided guidance in an area that has resulted in much litigation, namely, when does real estate become "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" within the meaning of Code section 1221(1). This Court held:

> "The purpose of the statutory provision with which we deal is to differentiate between the 'profits and losses arising from the everyday operation of a business' on the one hand (*Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 52) and 'the realization of appreciation in value accrued over a substantial period of time' on the other. (*Commissioner* v. *Gillette Motor Co.*, 364 U.S. 130, 134.) A literal reading of the statute is consistent with this legislative purpose. We hold that, as used in § 1221(1), 'primarily' means 'of first importance' or 'principally'."

383 U.S. 569, at 572.

Congress has made efforts over the years to clarify the law in this area commencing in 1954 with the addition of Code section 1237.

These cases taken together show that this Court has consistently construed the capital asset provisions narrowly because they represent an exception to the usual tax rules treating income and losses as ordinary. The *Corn Products* case is one case in this line. The Eighth Circuit's approach to construing Code section 1221 in *Arkansas Best* is inconsistent with these cases and should be reversed.

B. Taxation statutes are not literally construed when a literal construction is inconsistent with the intent of the statute.

When this Court put what the Eighth Circuit describes as a "judicial gloss", 800 F.2d 215, at 219, on Code section 1221 in *Corn Products*, it was not only construing the capital asset provisions narrowly but it was also acting in a manner consistent with many prior cases interpreting the revenue laws. In *Corn Products* this Court started from the assumption that "petitioner's corn futures do not come within the literal language of the exclusions set out in that section [117(a)]." 350 U.S. 46, at 51. However this Court then observed that:

> "Since this section [117] is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. *This is necessary to effectuate the basic congressional purpose.*" (emphasis added).

350 U.S. 46, at 52.

This Court has always sought to interpret the revenue laws as it did in *Corn Products* in a manner that ensures their purpose will be achieved.

For instance, it has long been established that literal compliance with the reorganization provisions is not sufficient to ensure tax-free treatment of a transaction. In *Pinellas Ice Co.* v. *Commissioner*, 287 U.S. 46, 77 L.Ed. 428, 53 S.Ct. 257 (1933), although the statute did not so require, this Court held that to qualify as a tax free reorganization:

> "... the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short-term purchase-money notes."

287 U.S. 462, at 470.

In *Gregory* v. *Helvering*, 293 U.S. 465, 79 L.Ed. 596, 55 S.Ct. 266 (1935), this Court held that a transaction which was in form a reorganization was in fact a dividend. In so holding, this Court determined that:

> "... the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose."

293 U.S. 465, at 470.

In *LeTulle* v. *Scofield*, 308 U.S. 415, 84 L.Ed. 355, 60 S.Ct. 313 (1940), this Court held that a reorganization was not tax-free where the consideration received was cash and long-term bonds. This Court prefaced its discussion of the reorganization provisions with the following observation:

> "As the court below properly stated, the section is not to be read literally, as denominating the transfer of all the assets of one company for what amounts to a cash consideration given by the other a reorganization."

308 U.S. 415, at 420.

In *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U.S. 179, 86 L.Ed. 775, 62 S.Ct. 540 (1942), this Court stated:

> "From the *Pinellas* case (287 U.S. 462) to the *LeTulle* case (308 U.S. 415) it has been recognized that a transaction may not qualify as a 'reorganization' under the various revenue acts though the literal language of the statute is satisfied."

315 U.S. 179, at 182.

In *Bazley* v. *Commissioner*, 331 U.S. 737, 91 L.Ed. 1782, 67 S.Ct. 1489 (1947), this Court held a purported recapitalization to be taxable after making the following observations:

> "Application of the language of such a revenue provision is not an exercise in framing abstract definitions. In a series of cases this Court has withheld the benefits of the reorganization provision in situations which might have satisfied provisions of the section treated as inert language, because they were not reorganizations of the kind with which § 112, in its purpose and particulars, concerns itself. See *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U.S. 462; *Gregory* v. *Helvering*, 293 U.S. 465; *LeTulle* v. *Scofield*, 308 U.S. 415."

331 U.S. 737, at 741.

Most recently, in *Paulsen* v. *Commissioner*, 469 U.S. 131, 83 L.Ed.2d 540, 105 S.Ct. 627 (1985), this Court reiterated these views.

> "Satisfying the literal terms of the reorganization provisions, however, is not sufficient to qualify for nonrecognition of gain or loss. The purpose of these provisions is "to free from the imposition of an income tax purely 'paper profits or losses' wherein there is no realization of gain or loss in the business sense but merely the recasting of the same interests in a different form." [citations omitted]."

469 U.S. 131, at 136.

In *Griffiths* v. *Commissioner*, 308 U.S. 355, 84 L.Ed. 319, 60 S.Ct. 277 (1939), this Court looked through an arrangement which was cast in form as an installment sale, but was in reality not an installment sale, with the following observation:

> "Legislative words are not inert, and derive vitality from the obvious purposes at which they are obtained, particularly in the provisions of a tax law like those governing installment sales in § 44 of the Revenue Act of 1932."

308 U.S. 355, at 358.

More recent examples of this Court construing the language of the tax laws are found in *Bob Jones University* v. *United States*, 461 U.S. 574, 76 L.Ed.2d 157, 103 S.Ct. 2017 (1983) and in *Hillsboro National Bank* v. *Commissioner*, 460 U.S. 370, 75 L.Ed.2d 130, 103 S.Ct. 1134 (1983). In *Bob Jones*, this Court held that:

> "... to warrant exemption under § 501(c)(3), an institution must fall within a category specified in that section and must demonstrably serve and be in harmony with the public interest."

461 U.S. 574, at 592.

In reaching this conclusion, this Court started from the premise that:

> "It is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute ..."

461 U.S. 574, at 586.

In *Hillsboro*, this Court held that the tax benefit rule (which was described by this Court as a "judicially developed principle that allays some of the inflexibilities of the annual accounting system", 460 U.S. 370, at 377), overrides the clear language of section 336 of the Code.

The *Corn Products* decision is consistent with these and other decisions of this Court that construe the specific language of the tax laws in a manner designed to ensure that the Congressional purpose is achieved. The Eighth Circuit decision in *Arkansas Best* does not construe the language of Code section 1221 in such a manner and thus should be reversed.

C. *Corn Products* was decided as it was at the urging of the Government, and it confirmed prior administrative practice and lower court decisions.

In considering *Corn Products*' roots, it should be remembered that it was decided as it was at the urging of the Government, and it confirmed prior administrative practice as well as lower court decisions.

The Government's Brief in *Corn Products*[6] argued strongly for the approach this Court ultimately took in its opinion:

> "A. In general, under the Code the annual profits derived from the ordinary carrying on of a trade or business are taxed as ordinary income. Preferential treatment is, however, accorded by Section 117 to the results of dealings in property, called capital assets, that are not the normal, direct source of business profits. The definition of a capital asset in Section 117 embodies an unusual draftsman's technique—the definition is specific only in stating what is *not* a capital asset. Taxpayer argues that because futures contracts do not fall strictly within the exclusions from Section 117 they must be held to be capital assets notwithstanding that they were employed, as held by both lower courts, as an integral part of the day-to-day operations of taxpayer's manufacturing business.
>
> Taxpayer's approach ignores the settled rule that the scope of the preferential capital gains provisions of the

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[6] Brief for the Petitioner, *Corn Products Refining Co.* v. *Commissioner*, *supra*, at 11-12 and 27.

Code is to be strictly construed. Thus in *Burnet* v. *Harmel*, 287 U.S. 103, 106, one of the first cases to reach this Court following the inclusion of capital gains provisions in the income tax law, the Court indicated that the new provisions were to be strictly construed to effect the congressional purpose of relieving the taxpayer from the 'excessive tax burdens on gains resulting from a conversion of capital investments' which it noted would often have accrued 'over long periods of time.' A necessary corollary of the rule that the capital asset definition of Section 117 is to be narrowly applied is that the exclusions from the capital asset definition shall be broadly applied so as not to frustrate the congressional purpose of limiting the preferential treatment to property in the nature of investments, not employed as an integral part of the day-to-day income producing activity of the taxpayer."

at 11-12.

"As this Court has indicated, the capital gains provisions must be read in the light of their purpose and in the context of the pattern of the income tax law which taxes ordinary income at full rates and grants exceptional treatment to capital gains and losses. So read, it becomes evident that Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments."

at 27.

In its opinion in *Corn Products*, this Court accepted these arguments. This Court also rested its decision on prior administrative practice as well as lower court decisions:

> "The problem of the appropriate tax treatment of hedging transactions first arose under the 1934 Tax Code revision. Thereafter the Treasury issued G.C.M. 17322, *supra*, distinguishing speculative transactions in commodity futures from hedging transactions. It held that hedging transactions were essentially to be regarded as insurance rather than a dealing in capital assets and that gains and losses therefrom were ordinary business gains and losses. The interpretation outlined in this memorandum has been consistently followed by the courts as well as by the Commissioner. While it is true that this Court has not passed on its validity, it has been well recognized for 20 years; and Congress has made no change in it though the Code has been re-enacted on three subsequent occasions. This bespeaks congressional approval."

350 U.S. 46, at 52-53.

Thus, the *Corn Products* decision was well-grounded on prior decisions of this Court, administrative practice and lower court decisions. The Eighth Circuit's suggestion that the decision was "misbegotten" is clearly erroneous.

II. THE *CORN PRODUCTS* DECISION IS A SENSIBLE AND PRACTICAL APPROACH TO CONSTRUING THE INTERNAL REVENUE CODE AND, UNTIL THE RECENT DECISION OF THE EIGHTH CIRCUIT, HAD BEEN ACCEPTED BY THE INTERNAL REVENUE SERVICE, THE COURTS AND CONGRESS.

The *Corn Products* decision has achieved broad acceptance since it was rendered in 1955 because it represents a sensible and practical approach to construing the Internal Revenue Code. Because the distinction between the treatment of gain or loss as ordinary or capital has made such a difference

under the tax laws and because the economic world is so varied and complex, it has been inevitable that a number of disputes have arisen as to where to draw the line between capital and ordinary. Decisions like *Corn Products*, which are grounded on construing statutes based upon their purpose, are essential to the proper functioning of the Federal tax system.

A. The Internal Revenue Service has, at least until recently, embraced the *Corn Products* decision and confirmed its applicability to capital stock.

As noted above the *Corn Products* decision represented an Internal Revenue Service victory. In numerous subsequent cases and in published rulings, the Internal Revenue Service embraced the rationale of *Corn Products* and aggressively argued that gains on the disposition of property acquired and held for business rather than investment purposes resulted in ordinary income.

For instance, in 1957, in its petition to this Court for a writ of certiorari in the *P. G. Lake* case,[7] the Government argued:

> "This Court has held that the capital gains provisions are to be 'narrowly applied' so as to effectuate the congressional policy of taxing at ordinary income rates the profits 'arising from the everyday operation of a business' while, at the same time, limiting preferential capital gain treatment 'to transactions in property which are not the normal source of business income.' *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, 52. And, as the *Corn Products* case demonstrates, a transaction may fit the literal language of the statute and yet not qualify for capital gain treatment where it does not fall within the obvious purpose of Congress and where a taxpayer would otherwise be able (pp. 53-54) 'to transmute ordinary income into capital gain at will.' Such is the situation here."

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[7] Petitioner's Brief for Certiorari, *Commissioner* v. *P. G. Lake, Inc.*, *supra*, at 17.

at 17.

In 1958, in *Rev. Rul. 58-40*, 1958-1 Cum. Bull. 275, relying principally upon *Corn Products*, the Internal Revenue Service ruled that stock, government bonds and debentures could give rise to ordinary income and loss in appropriate circumstances. In the examples in the ruling, the stock and debentures were purchased to obtain a source of supply of inventory. The government bonds were purchased in accordance with the terms of a contract and placed in escrow to guarantee performance under the contract. In *Rev. Rul. 58-40*, the Internal Revenue Service announced its acquiescence in two Tax Court cases which treated capital stock as an ordinary asset. *Western Wine & Liquor Co.*, 18 T.C. 1090 (1952), acq. 1958-1 Cum. Bull. 6 and *Charles A. Clark*, 19 T.C. 48 (1952), acq. 1958-1 Cum. Bull. 7. In its brief in the *Corn Products* case,[8] the Government had cited these cases (as well as *Commissioner* v. *Bagley & Sewall Co.*, 221 F.2d 944 (2nd Cir. 1955), a case involving escrowed government bonds, and several other cases) for the following proposition:

> "Significant, too, are decisions refusing capital gain or loss treatment to property which served a purpose directly related to the earning of normal business profits, even though the property did not come within the literal language of the statutory exceptions to the capital asset definition."

at 22.

In 1959, in its brief to this Court in *Gillette Motor Transport*,[9] the Government argued (citing among other cases *Corn Products*):

> "Section 117(a)(1) defines the term 'capital assets' generally as 'property' held by the taxpayer. However,

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[8] Brief for the Petitioner, *Corn Products Refining Co.* v. *Commissioner*, *supra*, at 22.

[9] Brief for the Petitioner, *Commissioner* v. *Gillette Motor Transport*, *supra*, at 17-18.

> 'property' as used in that section is not all-inclusive. The Congressional purpose in allowing a lower rate of taxation on the gain resulting from the conversion of capital assets is to ameliorate the burden which would be incurred by a taxpayer should that gain be classified as ordinary income in the year of a sale or exchange when the gain is due to appreciation in value over the period of investment, and to remove the deterrent effect of that burden on such conversions. [citations omitted]. This Court, in order to conform the statutory definition of 'capital assets' to that Congressional purpose, has always narrowly construed the definition. [citations omitted]."

at 17-18.

In *Rev. Rul. 70-64, supra*, (discussed in detail above), *Corn Products* and other cases were cited as the basis for concluding that the loss incurred by a chicken farmer on qualified written notices of allocation received from a farmers' cooperative was ordinary.

In *Rev. Rul. 72-238*, 1972-1 Cum. Bull. 65, *Corn Products* and *Gillette Motor Transport* were cited as the basis for concluding that gain realized by a bank in a foreclosure proceeding was ordinary income. Comparing the situation with that in *Corn Products*, the Internal Revenue Service stated:

> "Likewise, the gain involved here arises from the ordinary operation of the banking business."

1972-1 Cum. Bull. 65, at 66.

In *Rev. Rul. 75-13*, 1975-1 Cum. Bull. 67, the Internal Revenue Service again ruled, citing *Corn Products*, that the sale of stock could give rise to ordinary gain or loss. The ruling reviewed the holding of this Court in *Corn Products* and then stated:

> "In the light of the *Corn Products* case, subsequent courts have indicated that whether the sale or exchange of shares of stock gives rise to ordinary, as opposed to

> capital, gain or loss depends upon whether the taxpayer purchased and held the stock with a predominant business motive as distinguished from a predominant investment motive. Motive is determined by analyzing all the surrounding facts and circumstances."

1975-1 Cum. Bull. 67, at 68.

This ruling was revoked by *Rev. Rul. 78-94*, 1978-1 Cum. Bull. 58. In *Rev. Rul. 78-94*, the Internal Revenue Service continued to adhere to the view that the sale of stock can give rise to ordinary gain or loss, but it shifted the emphasis of the test which it believed proper to apply:

> "Revenue Ruling 75-13 is revoked since it is now the Service's position that even a predominant business motive cannot preclude the stock from capital gain or loss treatment, as long as there was a substantial investment motive for acquiring or holding the stock."

1978-1 Cum. Bull. 58, at 58.

While it might be questioned whether this shift of emphasis is proper given this Court's clear direction over the years that the capital provisions are to be narrowly construed, even in *Rev. Rul. 78-94* the Internal Revenue Service continued to recognize that there were circumstances where stock could be an ordinary asset.

In *Rev. Rul. 78-396*, 1978-2 Cum. Bull. 114, the Internal Revenue Service held that a foreign exchange loss incurred by a bank was under the circumstances ordinary "because the currency transaction did not have any substantial investment purpose, but was directly related to the taxpayer's business." 1978-2 Cum. Bull. 114, at 115. The ruling cites *Corn Products*.

B. *Corn Products* has been applied by lower courts in many cases over the past thirty years and no court, until the Eighth Circuit, thought it "misbegotten".

There have been literally hundreds[10] of decisions over the past 30 years that have applied the standards set forth in this Court's decision in *Corn Products* to a broad range of factual situations. Many of the cases have involved stock and have confirmed that, in appropriate circumstances, sales of stock may give rise to ordinary income or loss. See, *e.g.*, *Campbell Taggart, Inc.* v. *United States*, 744 F.2d 442 (5th Cir. 1984). The lower courts have found the concept set forth in *Corn Products* to be reasonable and workable. The focus of these courts on the purpose for acquiring and holding an asset is the proper focus. This Court should not depart from that approach at this late date.

C. Congress has accepted the result of the *Corn Products* case.

Since the *Corn Products* case was decided in 1955, Congress has revised the Internal Revenue Code on many occasions. Significant changes were made in 1958, 1962, 1964, 1969, 1971, 1974, 1976, 1978, 1981, 1982, 1984, and most recently in 1986. The changes in 1986 were so significant that Congress decided to rename the the Internal Revenue Code the Internal Revenue Code of 1986.

Congress has not amended the Internal Revenue Code to change the result of *Corn Products* and the numerous cases interpreting *Corn Products*. This is evidence of Congressional approval. See, *Corn Products*, 350 U.S. 46, at 52-53. Even a cursory review of Subchapter P (Capital Gains and Losses) of the Code (sections 1201-1288) reveals the time and effort that Congress has devoted over the years to distinguishing between capital gains and losses. Many of the special provisions contained in Subchapter P were Congressional

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[10]CCH current citator (through 4/8/87) lists 263 decisions that cite this Court's decision in *Corn Products*. *CCH 1987 Standard Federal Tax Reports, Citator (A-L)*.

responses to decisions of this and other courts (a few were noted above). Under the circumstances, the absence of a provision in the Code aimed at reversing *Corn Products*, and the cases that have followed it, is even stronger evidence of Congressional approval of the decision than might normally be the case where there is Congressional silence.

Congress is clearly aware of *Corn Products* and its implications. For instance, in 1986 Congress added Code section 988 to the Code to provide greater certainty as to the treatment of exchange gains and losses. Both the House Ways and Means and Senate Finance Committee Reports discussed the application of *Corn Products* to foreign currency transactions:

> "The term 'capital asset' includes all classes of property not specifically excluded by Section 1221 of the Code. Foreign currency generally falls within the definition of a capital asset; however, under *Corn Products Refining Co.* v. *Commissioner*, 350 U.S. 46 (1955), property that satisfies the literal language of section 1221 of the Code is not considered a capital asset if the property is used by the taxpayer as an integral part of a trade or business."

H.R. Rep. No. 426, 99th Cong., 1st Sess., 450 (note 19) (1985) and S. Rep. No. 313, 99th Cong., 2d Sess., 434 (note 5) (1986).

III. *MISSISSIPPI CHEMICAL* DID NOT REVERSE *CORN PRODUCTS SUB SILENTIO*.

The Eighth Circuit sought to rely on this Court's decision in *Mississippi Chemical* for support of its mistaken view that capital stock is always a capital asset. The Eighth Circuit's reliance is misplaced.

In *Mississippi Chemical* this Court was faced with the question as to whether certain amounts paid by Mississippi Chemical Corporation and Coastal Chemical Corporation, two fertilizer manufacturing cooperatives located in Mississippi, to purchase Class C stock of the New Orleans Bank for Cooperatives, which is also a cooperative, constituted additional interest costs of loans they had outstanding with the Bank.

The Farm Credit Act of 1955 provided for three classes of stock for the banks for cooperatives such as the New Orleans Bank for Cooperatives—Classes A, B and C. *Mississippi Chemical*, 405 U.S. 298, at 305. The class of stock which was the subject of the controversy in *Mississippi Chemical* was the Class C stock. Class C stock could only be issued to farmers cooperative associations. The stock could be acquired under only four circumstances:

> (1) One share was required to be purchased to initially qualify any association as a borrower from a district bank.
>
> (2) Each borrower was required to make quarterly stock purchases.
>
> (3) Class C stock could be issued as patronage refunds.
>
> (4) Borrowers received at the end of each fiscal year an "allocated surplus" credit payable out of the bank's net savings. When the surplus amount reaches 25% of the total outstanding capital stock of the bank, the excess could be distributed as Class C stock.

405 U.S. 298, at 306 and 307.

Only the tax treatment of the quarterly purchases of Class C stock was in dispute. 405 U.S. 298, at 307. The characterization of the Class C stock purchased by taxpayer as a capital asset was fixed as a capital asset on taxpayer's tax return. 405 U.S. 298, at 300.[11] The only issue before this Court was whether any portion of the purchase price of the quarterly stock purchase was in fact deductible as a "hidden" interest charge. 405 U.S. 298, at 300, 307 and 310. This Court discussed the various characteristics of the purchased Class C stock which affected its value and concluded that the stock was part of an overall scheme of financing for cooperatives which had a value over the long run. 405 U.S. 298, at 310 and 311. Even though the Government conceded that the stock was not worth the face amount of $100, this Court

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[11] Also see *Mississippi Chemical Corporation* v. *United States*, 431 F.2d 1320 (5th Cir. 1970), at 1321.

found that the stock had long-term value of $100 per share. 405 U.S. 298, at 311-312.

In its discussion of the character and value of the purchased stock this Court stated:

> "Since the security is of value in more than one taxable year, it is a capital asset within the meaning of § 1221 of the Internal Revenue Code, and its cost is nondeductible. Cf. *Commissioner* v. *Lincoln Savings & Loan Association*, 403 U.S. 345 (1971); *Old Colony R. Co.* v. *United States*, 284 U.S. 552 (1932); 26 CFR § 1.461-1."

405 U.S. 298, at 310.

It is respectfully submitted that the Eighth Circuit has accorded this reference to Code section 1221 significantly more weight than it deserves:

1) The three cited authorities all deal with whether an expenditure was deductible as an expense or had to be capitalized. No reference was made in these authorities to Code section 1221 or its predecessor, section 117 of the 1939 Code.

2) The reference to Code section 1221 was dicta as Code section 1221 was not at issue. The taxpayers in *Mississippi Chemical* had treated the purchased stock as a Code section 1221 asset on their respective returns. The only issue before the court in *Mississippi Chemical* was what portion of the payments made had to be capitalized as part of the purchase price.

3) The authorities cited in the above quotation deal with the timing of deductions, not whether the assets were capital assets.

4) Neither *Corn Products* nor the character of the asset to which payments were being allocated was at issue in *Mississippi Chemical*.

In summary, we find no support in this Court's opinion in *Mississippi Chemical* for the proposition that the holding of *Corn Products* does not apply to capital stock. The Eighth Circuit's reliance on *Mississippi Chemical* as support for its

attempt to overrule this Court's decision in *Corn Products*, is, to use the Eighth Circuit's terminology, "misbegotten".

CONCLUSION

The National Council of Farmer Cooperatives respectfully urges this Court to determine that the United States Court of Appeals for the Eighth Circuit was in error when it held that capital stock (other than that held in inventory by a securities dealer) must always be treated as a capital asset without regard to the reasons the stock was purchased and held.

May 5, 1987

Respectfully submitted,

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In The

Supreme Court of the United States

October Term, 1986

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF OF KRAFT, INC. AS AMICUS CURIAE IN OPPOSITION TO POSITION OF RESPONDENT

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QUESTION PRESENTED

Should *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955), and *Commissioner v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960), be overruled so that all transactions in stock are to be regarded as capital asset transactions under Section 1221 of the Internal Revenue Code of 1954 (and 1986) or should the Court continue to give effect to the original legislative intent of the capital asset provision and recognize the difference between property acquired for business purposes and property acquired for investment purposes?

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No. 86-751

In The
Supreme Court of the United States
October Term, 1986

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF OF KRAFT, INC. AS AMICUS CURIAE IN OPPOSITION TO POSITION OF RESPONDENT

INTEREST OF KRAFT, INC.

Kraft, Inc. ("Kraft"), with the consent of the parties, submits this Brief as Amicus Curiae in support of the position that the decisions in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29, *reh'g denied*, 350 U.S. 943, 76 S.Ct. 297, 100 L.Ed. 823 (1955), and *Commissioner v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960), are an essential part of the distinction made in Section 1221 of the Internal Revenue Code of 1954, as originally enacted in

1921, between property acquired and held for investment purposes and property acquired and held for business purposes. Kraft, a Delaware corporation, headquartered in Illinois, is the plaintiff in *Kraft, Inc. v. United States*, No. 804-86T (Cl. Ct. filed Dec. 23, 1986). A decision in the above-titled case may affect Kraft's position in its Claims Court case.

SUMMARY OF ARGUMENT

Amicus Curiae, Kraft, Inc., contends that the decision of the Eighth Circuit Court of Appeals in *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 800 F.2d 215 (8th Cir.), *cert. granted*, 94 L.Ed.2d 757, 55 U.S.L.W. 3643 (1986) is in error. Application of Section 1221 of the Internal Revenue Code of 1954 (and 1986), has not been literally applied except by the Eighth Circuit. *Id.* This Court acknowledged in 1955, at the urging of respondent, the United States, that a business purpose-investment purpose test is a necessary element in applying the ameliorative distinction between capital and ordinary transactions. *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955). Although the facts of *Corn Products* suggest to the Eighth Circuit no exception to the statutory language, the arguments made by respondent in *Corn Products* and the positions taken by it subsequent to that decision reflect a much broader and more realistic view of the type of transactions properly excepted from capital gain and loss treatment.

Corn Products is not unlike other decisions which apply provisions of the Internal Revenue Code ("Code") to the substance of a transaction consistent with the purpose of a Code section as articulated by Congress. The *Corn Products* doctrine as enunciated in 1955, at respondent's urging, has become an integral part of the "capital asset" definition first inserted in the Code in 1921. If respondent now wants to change this definition, it should go to Congress and not this Court.

I.

RESPONDENT'S ARGUMENT IN *CORN PRODUCTS* WAS ACCEPTED BY THIS COURT

Corn Products concerned futures contracts, "property [the equivalent] of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year". Section 117(a)(1) of the Internal Revenue Code of 1939, ch. 2, § 117(a), 53 Stat. 50 (1939). Neither respondent nor this Court appeared comfortable with a decision on the ground that the futures contracts were the equivalent of inventory, however. In its brief to this Court in *Corn Products*, filed on October 3, 1955, respondent argued as follows:

> As this Court has indicated, the capital gains provisions must be read in light of their purpose and in the context of the pattern of the income tax law which taxes ordinary income at full rates and grants exceptional treatment to capital gains and losses. So read it becomes evident that *Congress has made it as clear as the limitations of language permit* (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) *that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments.* (Emphasis added.)

Brief for Respondent at 27, *Corn Products*, 350 U.S. 46, Appendix A, *infra*, at A-4.

In this passage, and elsewhere in the same brief, respondent contended that the statutory language of Section 117(a)(1) of the Internal Revenue Code of 1939 was not to be read literally. Relying on a number

of decisions[1] involving the acquisition of securities (bonds and stock) purchased to secure a business as opposed to an investment advantage, respondent argued:

> That Congress did not intend that the net profit or loss resulting from the normal every-day operation of a business should qualify for the special treatment accorded to capital gains or losses is fully apparent from the exceptions stated in Section 117, which include (1) stock in trade, (2) inventory, (3) property held for sale to customers in the ordinary course of a trade or business, and (4) depreciable property used in the trade or business.
>
> * * *
>
> . . . [T]he exclusions from the capital asset concept of Section 117 must be broadly applied to effectuate the basic Congressional purpose.

Brief for Respondent at 18, 21, *Corn Products*, 350 U.S. 46, Appendix A at A-1, A-2.

This Court adopted respondent's analysis with only minor changes:

> Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the

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[1] *Commissioner v. Bagley & Sewall Co.*, 221 F.2d 944, 947 (2d Cir. 1955), (taxpayer allowed ordinary loss treatment on sale of bonds purchased as required security for performance of contract); *Commissioner v. Western Wine & Liquor Co.*, 18 T.C. 1090 (1952) (taxpayer, a wholesale liquor dealer, was allowed ordinary loss treatment on sale of stock purchased to insure right to purchase bulk whiskey), *appeal dismissed on government motion*, 205 F.2d 420 (8th Cir. 1953), *acq.*, 1958-1 C.B. 6; *Hogg v. Allen*, 105 F. Supp. 12 (M.D. Ga. 1952), *aff'd sub nom. Edwards v. Hogg*, 214 F.2d 640 (5th Cir. 1954). *See also* Rev. Rul. 58-40, 1958-1 C.B. 275.

> taxpayer from ... excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." *Burnet v. Harmel*, 287 U.S. at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term "capital assets" in § 117. See *Hort v. Commissioner*, 313 U.S. 28, 31; *Kieselbach v. Commissioner*, 317 U.S. 399, 403.

Corn Products, 350 U.S. at 52, 76 S.Ct. at 24.

Five years after the *Corn Products* doctrine was enunciated, this Court decided *Commissioner v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960), a case involving the taxability of compensation received for a temporary taking of real estate during wartime. Respondent argued that the term "property" in Section 117(a)(1) was not to be read as "all-inclusive". Brief for Respondent at 17, *Gillette Motor*, 364 U.S. 130, Appendix B, *infra*, at B-1. Recognizing the continued viability of respondent's argument this Court held that:

> While a capital asset is defined in § 117(a)(1) as "property held by the taxpayer," it is evident that not everything which can be called property in the ordinary sense *and which is outside the statutory exclusions* qualifies as a capital asset. This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year. *Burnet v. Harmel.* ... Thus the Court has held that an unexpired lease, *Hort v. Commissioner*, ... corn futures, *Corn Products Co. v. Commissioner*, ... and oil payment rights,

> *Commissioner v. P.G. Lake, Inc.*, . . . are not capital assets even though they are concededly "property" interests in the ordinary sense. (Citations omitted.) (Emphasis supplied.)

Gillette Motor, 364 U.S. at 134-35, 80 S.Ct. at 1500-01.

As explained in *Gillette Motor*, the *Corn Products* doctrine reflects the essential division between property acquired for business purposes and property acquired for investment purposes.[2] *Gillette Motor*, 364 U.S. at 135, 80 S.Ct. at 1501. The Commissioner has adopted the same distinction:

> [G]ains and losses resulting from the "operation of a business" must be distinguished from gains and losses incurred in "conversion of capital investments".

Rev. Rul. 72-238, 1972-1 C.B. 65, 66. In this ruling, the Commissioner relied on *Gillette Motor* and *Corn Products* and concluded that the gain realized when a creditor bank purchased mortgaged property at a foreclosure sale at a bid price less than the fair market value of the property was taxable as ordinary income. *See* Treas. Reg. § 1.166-6(b)(1); Rev. Rul. 72-238, 1972-1 C.B. at 66 (quoting *Gillette Motor*, 364 U.S. at 134, 80 S.Ct. at 1500). The Commissioner quoted the language in *Gillette Motor* stating that " . . . not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset." The Commissioner based his holding on the historical distinction between property "acquired and held . . . for profit and investment" and property acquired and held for business purposes:

> The gain realized by the bank on the exchange of the note receivable cannot be viewed as representing an "appreciation in value accrued over a substantial period of time".

Rev. Rul. 72-238, 1972-1 C.B. at 66.

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[2] *See also Commissioner v. Brown*, 380 U.S. 563, 570, 572, 85 S.Ct. 1162, 1165-67, 14 L.Ed.2d 75 (1965).

Respondent's position in *Corn Products* and *Gillette Motor* is equally applicable to stock as to the "property" at issue in those cases. Respondent's reliance upon *Western Wine* in its brief in *Corn Products* (Brief for Respondent at 22, *Corn Products*, 350 U.S. 46, Appendix A at A-3), and its later acquiescence in that case, 1958-1 C.B. 6, is significant. *See also* Rev. Rul. 58-40, 1958-1 C.B. 275. It makes clear that respondent has not historically been wed to the notion, adopted by the Eighth Circuit in *Arkansas Best*, 800 F.2d at 221, that stock can never be other than a capital asset. For respondent to contend otherwise suggests a shortsighted view of the history and application of the principle established in *Corn Products*.[3]

Rev. Ruls. 58-40 and 72-238, *supra*, are not isolated circumstances. Respondent has applied the *Corn Products* rationale in a variety of other situations:

1. Rev. Rul. 70-64, 1970-1 C.B. 36 (losses incurred by members of agricultural cooperative upon redemption of qualified written notices of allocation were ordinary losses);

2. Rev. Rul. 72-179, 1972-1 C.B. 57 (losses incurred by textile company on hedges to insure against market fluctuations in the price of cotton were ordinary losses);

3. Rev. Rul. 75-13, 1975-1 C.B. 67 (citing *Corn Products* and holding that the predominant motive of the purchaser and the surrounding circumstances are

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[3] In this regard, Amicus takes issue with the contention in Respondent's Brief in Response to the Petition for Certiorari in this case:

> [T]here is no justification for viewing the Court's opinion [in *Corn Products*] as creating a judge-made exception to the specific definition of "capital asset".

Br. at 12. In fact, what the Court did in *Corn Products* was to follow respondent's urging and adopt the *Western Wine* rationale.

important in determining whether worthless stock held by a corporate officer was acquired and held for investment or business reasons);

4. Rev. Rul. 78-94, 1978-1 C.B. 58, revoking Rev. Rul. 75-13, (adopts the holding in *W. W. Windle Co. v. Commissioner*, 65 T.C. 694, *appeal dismissed*, 550 F.2d 43 (1st Cir. 1976), *cert. denied*, 431 U.S. 966, 97 S.Ct. 2923, 53 L.Ed.2d 1062 (1977), which restricts application of *Corn Products* to cases where there is no "substantial" investment motive); and

5. Rev. Rul. 78-414, 1978-2 C.B. 214 (motive important in analyzing tax treatment of taxpayer's purchase of commodity futures contracts for future delivery of Treasury bills).

II.

CORN PRODUCTS IS CONSISTENT WITH DECISIONS WHICH APPLY THE INTERNAL REVENUE CODE IN HARMONY WITH THE UNDERLYING CONGRESSIONAL INTENT

The decision in *Corn Products* is consistent with a series of cases, beginning even before *Burnet v. Harmel*, 287 U.S. 103, 53 S.Ct. 74, 77 L.Ed. 199 (1932), which have sought to interpret rather than apply dogmatically the provisions of the Code. These decisions are reflective of a Congressionally approved purpose that when applying the various provisions of the Code, courts should render decisions in harmony with the legislative intent rather than in lockstep with the literal language of statutory provisions.

Helvering v. Alabama Asphaltic Limestone Co., 315 U.S. 179, 62 S.Ct. 540, 86 L.Ed. 775 (1942), involved application of the "continuity of interest" doctrine first enunciated in *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462, 53 S.Ct. 257, 77 L.Ed. 428 (1933). That doctrine provides that a transaction will not be treated as a tax-free reorganization unless the seller maintains a

continuing interest in the reorganized entity. In *Alabama Asphaltic*, the Court described the prior cases in the following language:

> From the *Pinellas* case (287 U.S. 462) to the *LeTulle* case (308 U.S. 415) it has been recognized that a transaction may not qualify as a "reorganization" under the various revenue acts though the literal language of the statute is satisfied.

Alabama Asphaltic, 315 U.S. at 182, 62 S.Ct. at 542-43. This Court clearly recognized that to require only literal compliance with the statute would defeat Congress' purpose.

Judge Hand made the identical point in the Second Circuit's opinion in *Helvering v. Gregory*, 69 F.2d 809 (2d Cir. 1934), *aff'd, Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935), the case in which this Court engrafted the "business purpose" doctrine onto the reorganization provisions of the Code. *See Gregory v. Helvering*, 293 U.S. at 470, 55 S.Ct. at 268. In describing a transaction which met the literal requirements of a "reorganization" but which lacked an apparent business purpose, Judge Hand wrote:

> Nevertheless, it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition.

Helvering v. Gregory, 69 F.2d at 810.

These decisions, like *Corn Products*, affirm the courts' role in the application and interpretation of the Code. Without them, the Code would need to be longer and more complex than it already is. Respondent recognized this fact in its brief to this Court in *Corn Products* when it said:

> Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable kind of business) that profits and losses derived from the normal operation of a business are not to receive the

> special tax considerations reserved for [capital assets]. . . .

Brief for Respondent at 27, *Corn Products*, 350 U.S. 46, Appendix A at A-4. The increasing complexity of the business world makes this statement at least as true, if not more true, in 1987 as it was in 1955.

Alabama Asphaltic and *Gregory v. Helvering* are instructive in the present case for other reasons. First, the continuity of interest, business purpose and *Corn Products* doctrines were adopted by this Court at respondent's urging. Second, the continuity of interest and business purpose doctrines are each more than fifty-years old. During their existence, the reorganization sections of the Code have been amended numerous times and their precision, breadth and complexity have increased.[4] Despite these legislative enactments, the continuity of interest and business purpose doctrines remain vital and acknowledged additions to the Code definitions of reorganizations.[5]

The *Corn Products* doctrine though of more recent

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[4] Some of the amendments speak directly to aspects of the doctrines, *e.g.*, Section 368(a)(1)(B) incorporated one aspect of the continuity of interest doctrine by restricting the permissable consideration in stock for stock reorganizations to "voting stock". Section 368(a)(2)(B) was added to permit minor amounts of cash to be used in stock for asset reorganizations.

[5] In his article, *Definitional Problems in Capital Gains Taxation*, 69 HARV. L. REV. 985, 995 (1956), Professor Surrey compared the facts in *Gregory v. Helvering* with situations involving "corn futures, . . . government bonds, and . . . debentures," and stated . . . that the latter set of examples –

> are not tax avoidance distortions. They involve everyday business-motivated transactions. But they forced the judicial action taken in reference to them because of the failure of Congress to face up realistically to the tremendous classification problem inherent in the attempted division between "investment" and "business". Put more narrowly, the decisions represent the courts' view

(Footnote continued on the following page)

vintage (32 years) has, until now, been recognized by the courts and the respondent as a vital constructional element in the implementation of the acknowledged legislative intent of restricting capital asset treatment to investment-type activities. The original need for the *Corn Products* doctrine remains. Both respondent's argument and the Court's decision in *Corn Products* were in harmony with the overriding theme that the substance or business purpose of a transaction controls its taxability.

III.

CORN PRODUCTS IS CONSISTENT WITH THE LEGISLATIVE HISTORY OF SECTION 1221 AND ITS PREDECESSOR PROVISIONS

The legislative history of Section 1221, and its predecessor provisions, supports the decision in *Corn Products*.

Section 206(a)(6) of the Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (1921), the original predecessor of Section 117(a) of the 1939 Code and Section 1221 of the 1954 (and 1986) Code, recognized the distinction between property "acquired and held by taxpayer for profit and investment" and other property. The statutory language provided as follows:

> The term "capital assets" as used in this section means *property acquired and held by the taxpayer for profit and investment for more than two years* (whether or not connected with his trade or

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5 *(Continued)*

> that Congress has not realistically faced the problem and therefore did not desire to be taken literally when it used the broad term "property" in section 1221. The courts are willing to rescue Congress from its statutory strait jacket.

To the extent respondent relied upon *Bagley & Sewall* (bonds) and *Western Wine* (stock) in *Corn Products* (corn futures), (Appendix A at A-3), it agreed with Prof. Surrey's analysis and endeavored to apply a common sense interpretation to the basic statutory language.

> business), but does not include property held for his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the end of the taxable year. (Emphasis added.)

Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (1921).

On February 7, 1924, H.R. 6715 was introduced in the House of Representatives. Section 208(a)(8) of H.R. 6715 provided as follows:

> The term "capital assets" means *property held by the taxpayer for profit or investment for more than two years* (whether or not connected with his trade or business) but does not include stock in trade of the taxpayer or other property held by the taxpayer primarily for sale. (Emphasis added.)

H.R. 6715, 68th Cong., 1st Sess. § 208(a)(8) (1924).

H.R. 6715 was adopted by the House, with amendments, and introduced in the Senate on February 29, 1924. The proposed bill, as amended in the House and adopted by the Senate, provided as follows:

> The term "capital assets" means *property held by the taxpayer for more than two years* (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. (Emphasis added.)

Revenue Act of 1924, ch. 234, § 208(a), 43 Stat. 263 (1924).

Thus, Congress in 1924 dropped the qualitative "acquired and held . . . for profit and investment" test and left the mechanical "held . . . for more than two years" test for determining whether property should be regarded as a "capital asset". This Court has stated, however, that the 1921 provision was "reenacted in 1924 without material change." *Burnet v. Harmel*, 287 U.S. at 106, 53 S.Ct. at 75.

Thus, while the statutory language was modified in 1924, the Court did not consider the original intent of the provision – to provide special tax treatment for assets "acquired and held ... for profit and investment", in contrast to assets acquired for use in a business – to have changed.

The only noteworthy addition to the "capital asset" provision in 1924 was with respect to "property held by the taxpayer primarily for sale in the course of his trade or business." In commenting upon the 1924 addition to the language of the 1921 Act, the House Ways and Means Committee stated:

> The last part of the definition of capital assets is changed to *remove any doubt* as to whether property which is held primarily for resale constitutes a capital asset whether or not it is the type of property which under good accounting practice would be included in the inventory. (Emphasis added.)

H. REP. No. 179, 68th Cong., 1st Sess. 19 (1924), *reprinted in* 1939-1 (Part 2) C.B. 241, 255.

The "remove any doubt" language reflects a Congressional acknowledgment that the exceptions to the "capital asset" definition enumerated in Section 208(a)(8) of the 1924 Act were not intended to be exclusive. As originally enacted as Section 206(a)(6) of the 1921 Act, the "capital asset" definition was intended to apply to "property acquired and held by the taxpayer for profit and investment." *See Burnet v. Harmel*, 287 U.S. at 106, 53 S.Ct. at 75.

The enactments of Congress in 1921 and 1924, the pertinent legislative history and this Court's previous analysis do not reflect an intent by Congress to enact a literal, unbending provision. The legislative history of this provision, both prior to and subsequent to the *Corn Products* decision, is replete with opportunities when Congress could have modified the principle announced in *Burnet v. Harmel*

and enlarged in *Corn Products* and *Gillette Motor*, that in applying the statutory definition of "capital assets" and its enumerated exclusions, the distinction between property "acquired and held ... for profit and investment" and property acquired for business uses must be paramount.[6]

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[6] There have been enacted frequent legislative modifications to the list of exceptions to the term "capital assets" since 1924. In 1934, the "*to customers* in the *ordinary* course of his trade or business" language was added. (Modifications italicized.) Revenue Act of 1934, ch. 277, § 117(b), 48 Stat. 714 (1934); H. REP. NO. 1385, 73d Cong., 2d Sess. 22 (1934), *reprinted in* 1939-1 (Part 2) C.B. 627, 632. The mechanical "for more than two years" test was also deleted in the Revenue Act of 1934. *Id.* According to the House Report, the "two year" period previously in effect could only be defended on the "ground of expediency". H. REP. NO. 704, 73d Cong., 2d Sess. 10 (1934), *reprinted in* 1939-1 (Part 2) C.B. 554, 562. The predecessor to current Section 1221(2) was added in the Revenue Acts of 1938 and 1942. Revenue Act of 1938, ch. 289, § 117(a) (1), 52 Stat. 500 (1938); Revenue Act of 1942, ch. 619, § 151(a), 56 Stat. 846 (1942). In 1950, Congress excluded copyrights, as well as literary, musical and artistic compositions from the "capital asset" definition. Revenue Act of 1950, ch. 994, § 210(a), 64 Stat. 933 (1950); H. REP. NO. 3124, 81st Cong., 2d Sess. 27 (1950).

In the 1954 recodification, Section 1221(4), relating to accounts and notes receivable, was added to the list of property specifically excluded from the term "capital assets". Internal Revenue Code of 1954, ch. 736, § 1221(4), 68A Stat. 321 (1954).

Section 1221(3) was further amended in 1969 with the addition of an exception relating to letters or memoranda created by or for a taxpayer. Tax Reform Act of 1969, Pub. L. No. 91 – 172, § 514(a), 83 Stat. 643 (1969); *see Morrison v. Commissioner*, 71 T.C. 683 (1979), *aff'd*, 611 F.2d 98 (5th Cir. 1980).

Present Section 1221(5) was added in the Tax Reform Act of 1976. Pub. L. No. 94 – 455, § 2132(a), 90 Stat. 1925 (1976); S. REP. NO. 1236, 94th Cong., 2d Sess. 532 (1976). Section 1221 was amended again in 1981 with the deletion of former Section 1221(5) relating to short-term government obligations issued at a discount. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 505(a), 95 Stat. 338 (1981); H. REP. NO. 215, 97th Cong., 1st Sess. 260 (1981).

IV.

DESPITE FREQUENT LEGISLATIVE ACTIVITY CONCERNING THE DEFINITION OF "CAPITAL ASSETS", NO EFFORT HAS BEEN MADE TO REFORM OR RESTRICT THE SCOPE OF *CORN PRODUCTS*

Recent legislative history makes clear that where Congress has disapproved of a judicial interpretation, it has not been reluctant to change the judicially created rule. The doctrine that a corporation does not realize taxable income upon distributing appreciated property to its shareholders, set forth in *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200, 56 S.Ct. 185, 80 L.Ed. 154 (1935), and thereafter codified in Sections 311(a)(2), 336 and 337 of the Internal Revenue Code of 1954, was eliminated in the Internal Revenue Code of 1986. Tax Reform Act of 1986, Pub. L. No. 99-514, § 631, 100 Stat. 2085 (1986).

In the significant legislative enactments which have occurred since the *Corn Products* and *Gillette Motor* decisions, Congress has never sought to cut back on the Court's holdings. Rather, the enactments regarding Section 1221, *see supra* note 6, have dealt with the periphery of the "capital asset" definition and have not sought to negate the *Corn Products* doctrine.[7]

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[7] Significantly, in Rev. Rul. 75-533, 1975-2 C.B. 359, 360, the Commissioner stated as follows with respect to another of his interpretations of the Code:

> [S]ection 20.2055-1 has existed in substantially the same form since 1921 and has been consistently construed and applied by the courts on many occasions. Such continuous existence and consistent application of the unambiguous regulation, together with reenactment of the construed legislation, "bespeaks congressional approval," *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 53 (1955), and the regulation has "acquired the force of law," *Cammarano v. United States*, 358 U.S. 498, 510 (1958).

V.

THE DECISION OF THE EIGHTH CIRCUIT IN *ARKANSAS BEST* IS IN ERROR

Whether the *Corn Products* doctrine applies in the circumstance of *Arkansas Best* is as much a factual as a legal determination. One thing is certain, however, the decision of the Eighth Circuit is in error.[8] The application of Section 1221 should not be determined by its literal language. In its brief in *Corn Products*, the government cited approvingly cases, *see supra* note 1, where taxpayers had acquired securities (bonds and stocks) for business rather than investment purposes. As the government argued:

> Significant, too, are decisions refusing capital gain or loss treatment to property which served a purpose directly related to the earning of normal business profits, even though the property did not come within the literal language of the statutory exceptions to the capital asset definition.

Brief for Respondent at 22, *Corn Products*, 350 U.S. 46, Appendix A at A-3.

Respondent's present effort to move away from the position which it urged this Court to accept in 1955 in *Corn Products* and in 1960 in *Gillette Motor* and which it has adopted in various revenue rulings, *supra* pp. 6–8, should be rejected by the Court. As the Court said in *Fribourg Navigation Co. v. Commissioner*, 383 U.S. 272, 86 S.Ct. 862, 15 L.Ed.2d 751 (1966):

> The Commissioner's position represents a sudden and unwarranted volte-face from a consistent administrative and judicial practice . . .
>
> * * *
>
> Congress repeatedly re-enacted the depreciation

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[8] Indeed, Amicus would suggest that the Court does not have to reach the underpinnings of the *Corn Products* doctrine to decide the instant case. It can conclude that the Eighth Circuit's literal approach is in error and follow the factual conclusion of the Tax Court regarding taxpayer's "business" intent.

> provision without significant change. Thus, beyond the generally understood scope of the depreciation provision itself, the Commissioner's prior long-standing and consistent administrative practice must be deemed to have achieved congressional approval.

383 U.S. at 279, 283, 86 S.Ct. at 867, 869.

While the change in position as respects the *Corn Products* doctrine is arguably not as egregious as that in *Fribourg*, on account of respondent's earlier effort to persuade this Court to revisit *Corn Products* (*see* Petition for Certiorari filed in *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869, 91 S.Ct. 103, 27 L.Ed.2d 109 (1970), (filed July 17, 1970), *but cf.* the revenue rulings cited and discussed *supra* pp. 6–8, which were issued *after* respondent's petition in *Waterman, Largen* was filed), the fundamental fact remains that Congress has never taken up the cudgel for the Commissioner on this issue.[9] Further, it is not apparent that the Commissioner has made any serious effort to reform or modify the *Corn Products* doctrine through legislation in the more than 30 years since its argument was accepted by this Court. To paraphrase the Court's decision in *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149, 94 S.Ct. 2129, 2137, 40

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[9] In *Commissioner v. Brown*, 380 U.S. at 579, 85 S.Ct. at 1170, a case involving the application of Section 1221(3) of the Internal Revenue Code of 1954, in the context of a sale of a business to an exempt organization, this Court stated:

> [I]f the Commissioner's approach is intended as a limitation upon the tax treatment of sales generally, it represents a considerable invasion of current capital gains policy, a matter which we think is the business of Congress, not ours.

See also American Automobile Assn. v. United States, 367 U.S. 687, 697, 81 S.Ct. 1727, 1732, 6 L.Ed.2d 1109, *reh'g denied*, 368 U.S. 870, 82 S.Ct. 24, 76 L.Ed.2d 70 (1961), where the Court left to Congress "the fashioning of a rule, which, in any event, must have wide ramifications."

L.Ed.2d 717 (1974), the Commissioner has freely argued for a certain judicial interpretation; that interpretation was accepted by this Court in *Corn Products* and *Gillette Motor* and has become a fundamental precept of the "capital asset" definition; accordingly, the Commissioner should be obliged to abide by that interpretation in the absence of Congressional action to the contrary.

CONCLUSION

For the foregoing reasons, Amicus Curiae respectfully urges the Court to reaffirm the principle that the decisions in *Corn Products* and *Gillette Motor* are essential elements in the distinction made in Section 1221 of the Internal Revenue Code, and its predecessor provisions, between property acquired and held for investment purposes and property acquired and held for business purposes.

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APPENDIX A

In The Supreme Court of the United States

OCTOBER TERM, 1955

No. 20

CORN PRODUCTS REFINING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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* * *

Brief, at 18-19:

The definition of a capital asset in Section 117 embodies an unusual draftsman's technique — the definition is specific only in stating what is *not* a capital asset. The congressional purpose in granting special tax preference to gains from, and of limiting the deductions of losses on, the sale or exchange of capital assets must be gleaned from the exceptions enumerated in the statute, *i. e.*, from the kinds of gains or losses which do not qualify for special consideration.

That Congress did not intend that the net profit or loss resulting from the normal every-day operation of a business should qualify for the special treatment accorded to capital gains or losses is fully apparent from the exceptions stated in Section 117, which include (1) stock in trade, (2) inventory, (3) property held for sale to customers in the ordinary course of a trade or business, and (4) depreciable property used in the trade or business.

The taxpayer's claim to capital asset treatment of its futures transactions rests on a simple syllogism: its futures contracts were "property"; they were not its stock in trade; they did not (strictly) form part of its inventory; they were not being held for sale to customers and they were not subject to depreciation. With these statements we agree. But we disagree with the conclusion that taxpayer draws, namely, that since the futures contracts do not come within the precise words of the enumerated exceptions, they must be classified as capital assets. (Br. 13–15, 32–33, 36–37.)

* * *

Brief, at 21-23:

This approach has two aspects, in view of the form of Section 117. On the one hand, as this Court indicated in *Burnet v. Harmel*, 287 U. S. 103, the usual rule that statutory exceptions from income tax under the provisions of the Internal Revenue Code are to be stictly construed, requires that the capital asset definition be narrowly applied. See *Ogle v. Helvering*, 77 F. 2d 338, 339 (C. A. 2d); *Sloane v. Commissioner*, 188 F. 2d 254 (C. A. 6th). As a necessary corollary, the exclusions from the capital asset concept of Section 117 must be broadly applied to effectuate the basic Congressional purpose.

Thus, this Court and the lower courts have consistently refused, in a wide variety of circumstances, to treat as capital gain, or as a return of a capital investment, receipts which are not the kind of gain for which the statute intended preferential treatment. In many situations capital gain or loss has been denied, even though, superficially, the transactions qualified under the literal language of the capital–gains provisions. See *e.g.*, *Kieselbach v. Commissioner*, 317 U. S. 399 (portion of lump–sum condemnation award which represented compensation for delay in payment taxed as ordinary income); *Hort v. Commissioner*, 313 U. S. 28 (lump sum received for cancellation of lease regarded as a substitute for rent,

taxable as ordinary income, rather than as proceeds from sale of lease); *Helvering v. Smith*, 90 F. 2d 590 (C. A. 2d), and *Doyle v. Commissioner*, 102 F. 2d 86 (C. A. 4th) (sale of right to receive legal fee for services rendered, taxed as ordinary income rather than as sale of capital asset); *Rhode's Estate v. Commissioner*, 131 F. 2d 50 (C. A. 6th) (sale of right to receive previously declared dividend held not taxable as sale of capital asset); *Fisher v. Commissioner*, 209 F. 2d 513 (C. A. 6th), certiorari denied, 347 U.S. 1014 (sale of past–due interest taxable as ordinary income); *Shuster v. Helvering*, 121 F. 2d 643 (C. A. 2d) (payment received on cancellation of employment contract taxable as ordinary income).

Significant, too, are decisions refusing capital gain or loss treatment to property which served a purpose directly related to the earning of normal business profits, even though the property did not come within the literal language of the statutory exceptions to the capital asset definition. *Commissioner v. Bagley & Sewall Co.*, 221 F. 2d 944, 947 (C. A. 2d) (loss on United States bonds purchase in order to meet contract requirement that they be posted as security for performance of the contract and sold when released in accordance with the contract, held deductible as ordinary loss). See also, *Commissioner v. Western Wine & Liquor Co.*, 18 T. C. 1090, appeal dismissed, 205 F. 2d 420 (C. A. 8th); *Clark v. Commissioner*, 19 T. C. 48, appeal dismissed June 18, 1953 (C. A. 9th), and *Hogg v. Allen*, 105 F. Supp. 12 (M. D. Ga.), affirmed on this point, *sub. nom. Edwards v. Hogg*, 214 F. 2d 640 (C. A. 5th) (taxpayers who were in business of buying and selling whiskey and who purchased shares of stock in distilling companies in order to have opportunity of purchasing, on favorable terms, whiskey which was in short supply did not suffer capital loss on later disposition of the shares of stock, the loss being held to constitute a part of the cost of acquiring the inventory of whiskey); *Helvering v. Community Bond & Mortgage Corp.*, 74 F. 2d 727 (C. A. 2d) (loss on stock of

another corporation purchased in order to dissolve it, thus cancelling an unprofitable contract with such corporation, held deductible as a business expense).

* * *

Brief, at 27-28:

Recognizing that the construction of Section 117 for which it contends is opposed to the established rule applicable to hedging transactions, taxpayer now seeks to attack the validity of that rule, even as it applies to "true" hedging operations (see Br. 18). It is led to do this because futures contracts do not, in the strict sense of the words, represent stock in trade, inventory, property held for sale to customers, or depreciable property used in a trade or business, i. e., strictly speaking, as urged by taxpayer, they do not fall within the broad categories of property excluded from the definition of a capital asset. But in this attack, taxpayer must fail. As this Court has indicated, the capital gains provisions must be read in the light of their purpose and in the context of the pattern of the income tax law which taxes ordinary income at full rates and grants exceptional treatment to capital gains and losses. So read, it becomes evident that Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments. "The purpose is to protect 'investment property' as distinguished from 'stock in trade,' or property bought and sold for a profit." *Rollingwood Corp. v. Commissioner*, 190 F. 2d 263, 266 – 267 (C. A. 9th). *Accord: Kenan v. Commissioner*, 114 F. 2d 217, 220 (C. A. 2d); *Commissioner v. Shapiro*, 125 F. 2d 532, 535 – 536 (C. A. 6th); *Rieger v. Commissioner*, 139 F. 2d 618, 621 (C. A. 6th); *Watson v. Commissioner*, 197 F. 2d 56, 58 (C. A. 9th), affirmed, 345 U. S. 544.

* * *

APPENDIX B

In The Supreme Court of the United States

OCTOBER TERM, 1959

No. 359

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GILLETTE MOTOR TRANSPORT, INC.

WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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* * *

Brief, at 17-19:

2. The definition of the term "capital assets"

Section 117(a)(1) defines the term "capital assets" generally as "property" held by the taxpayer.[7] However, "property" as used in that section is not all – inclusive. The Congressional purpose in allowing a lower rate of taxation on the gain resulting from the conversion of capital assets is to ameliorate the burden which would be incurred by a taxpayer should that gain be classified as ordinary income in the year of a sale or exchange when the gain is due to appreciation in value over the period of investment, and to remove the deterrent effect of that burden on such conversions. *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260, 265, 266, rehearing denied, 356 U.S. 964; *Corn Products Co. v. Commissioner*, 350 U.S. 46, 52, rehearing

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[7] Subparagraphs (A) and (B) of Section 117(a) (1) contain certain exclusions from this definition.

denied, 350 U.S. 943; *Burnet v. Harmel*, 287 U.S. 103, 106, 111; *United States v. Snow*, 223 F. 2d 103, 109 (C.A.9), certiorari denied, 350 U.S. 831; *Fisher v. Commissioner*, 209 F. 2d 513, 514 (C.A. 6), certiorari denied, 347 U.S. 1014; *Boomhower v. United States*, 74 F. Supp. 997, 1001 (N. D. Iowa). This Court, in order to conform the statutory definition of "capital assets" to that Congressional purpose, has always narrowly construed the definition. *Corn Products Co. v. Commissioner*, *supra*, p. 52; *Commissioner v. P. G. Lake, Inc*, *supra*, p. 265.

The problem often presented, and which is raised in this case, is to determine whether a conversion of a taxpayer's capital investment has occurred. The controlling distinction (based on the principles discussed in the previous paragraph) is that, when gain is realized upon the conversion of assets which have appreciated in value and which otherwise meet the definition of "capital assets", the gain is treated as capital gain whereas gain realized from the *use* of such an asset is treated as ordinary income. The latter type of transaction does not result in the burden aimed at by the capital gains provisions, and is therefore not accorded capital gain treatment. *Commissioner v. P.G. Lake, Inc.*, *supra*, p. 266; *Burnet v. Harmel*, *supra*, p. 106; *United States v. Snow*, *supra*, p. 109; *Fisher v. Commissioner*, *supra*, p. 514; *Mathey v. Commissioner*, 10 T.C. 1099, 1105, affirmed, 177 F. 2d 259 (C.A. 1), certiorari denied, 339 U.S. 943; *Eaton v. Commissioner*, 10 T.C. 869, 881-882; Rev. Rul. 38, 1953-1 Cum. Bull. 16, 17. Cf. *Anderson v. Helvering*, 310 U.S. 404, 407; *Raytheon Production Corp. v. Commissioner*, 144 F. 2d 110, 113 (C.A. 1), certiorari denied, 323 U.S. 779; *Marcalus Manufacturing Co. v. Commissioner*, 30 T.C. 1345, 1350–1353, affirmed *per curiam sub nom. Marcal Pulp & Paper, Inc. v. Commissioner*, 268 F. 2d 739 (C.A. 3), certiorari

denied, December 14, 1959, No. 516, this Term.[8] Another way of putting the difference is to use the distinction between a "tree" and its "fruit" found in the assignment–of–income cases (see, for example, *Lucas v. Earl*, 281 U.S. 111, 115). In those terms, the conversion of the "tree" into gain results in capital gain; the conversion of the "fruit" of a tree into gain results in ordinary income.

These general principles are fully applicable to the present case. Although the intangible right of the taxpayer to use, for the period of ten months, assets in which it owned the fee may be considered property in one sense, it is not "property" which can be converted in the "capital gains" sense – as we shall show. The basic error of the court below is its refusal to recognize this distinction.

* * *

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[8] In a discussion by Professor Stanley S. Surrey of the results that would flow from an interpretation giving the word "property" in Section 117(a)(1) an all – inclusive meaning, the example of a claim for salary is used, but comparable reasoning would apply in the case of a claim for compensation for the use of property. Surrey's observations are as follows (*Definitional Problems in Capital Gains Taxation*, 69 Harv. L. Rev. 985, 988 fn. 7 (1956)):

"Thus, since a claim to salary is certainly 'property' in one sense of the term, the claim to salary would in that sense be a capital asset. While payment of the salary would not produce a capital gain because of the "sale or exchange" requirement under the existing interpretation of "exchange," a sale of the claim would produce a capital gain under this interpretation of property. And, if this interpretation were adopted, we might well find a national brokerage business developing overnight through which employees sold their salary claims. In effect, the "sale or exchange" requirement would not suffice to stem the capital gain flood waters if "capital asset" were all – inclusive. * * * "

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No. 86-751

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARKANSAS BEST CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

BRIEF OF AMICUS CURIAE THE CIRCLE K CORPORATION IN SUPPORT OF PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

NO. 86-751

ARKANSAS BEST CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

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BRIEF OF AMICUS CURIAE THE CIRCLE K CORPORATION IN SUPPORT OF PETITIONER*

THE INTEREST OF AMICUS CURIAE

The Circle K Corporation ("Circle K") is the plaintiff in a case now pending before the United States Claims Court, *The Circle K Corporation v. United States*, No. 12-86 T. A major issue in that case involves the application of this Court's decision in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), to Circle K's purchase and sale of shares of stock of a corporation which owned producing oil and gas reserves.

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* Both Petitioner and Respondent have consented to the filing of this brief, and the written consents are on file with the Clerk. The decision below is reported at 800 F.2d 215 (8th Cir. 1986).

Circle K is an operator of convenience stores with its headquarters in Phoenix, Arizona. In the early 1960's, Circle K pioneered the operation of self-service gasoline facilities at its convenience stores, and by 1980 gasoline sales accounted for approximately 30% of Circle K's total sales and produced customer traffic for a substantial percentage of its non-gasoline sales.

Gasoline shortages in 1973-1974 and 1979-1980, and the continued threat of future gasoline shortages, prompted Circle K's management to seek arrangements for insuring adequate and reliable sources of gasoline for its stores. In pursuit of this goal, Circle K tried during the 1960's and 1970's to obtain long-term supply contracts with major oil companies for refined gasoline and tried to acquire refineries. For various reasons all of these attempts failed, and by the end of the 1970's, Circle K remained without a reliable source of supply.

In 1980, Circle K's attention was directed toward Nucorp Energy, Inc. (Nucorp) as a possible solution to its gasoline supply problem. Nucorp was an oil and gas exploration and development company which had major producing oil and gas reserves. After investigation and negotiations between Circle K and Nucorp, Circle K purchased a substantial amount of Nucorp stock in order to obtain a source of supply of gasoline in the event shortages again occurred.

Nucorp expanded rapidly thereafter, incurring substantial debt. As world-wide oil shortages ended in the early 1980's and the price of oil dropped rapidly, Nucorp's financial situation became precarious, and in July of 1982, Nucorp filed for reorganization under Chapter 11 of the Federal Bankruptcy Code. In early 1983, after it was clear that Nucorp would not continue to be an available solution to the supply problem, Circle K sold its stock in Nucorp, suffering a substantial loss.

Circle K deducted the loss as an ordinary loss on its income tax return for its fiscal year ended April 30, 1983, based on this Court's decision in *Corn Products* and related cases. The loss was disallowed on audit by the Internal Revenue Service, Circle K paid the resulting deficiency, filed a Claim for Refund and, after the claim was disallowed, filed suit for refund of the tax paid in the United States Claims Court. The Government's discovery in the Claims Court case is almost completed, and the trial will probably be completed before the end of 1987 unless it is postponed pending this Court's decision in this case.

If this Court should affirm the opinion below, holding that shares of stock can never be treated as anything other than capital assets when held by a taxpayer other than a securities dealer, no matter why they were purchased, held and sold, and regardless of the attendant circumstances, that affirmation will adversely affect Circle K's refund suit on this issue. If this Court instead reaffirms the principles set forth in its *Corn Products* decision, Circle K will be given the opportunity to prove that its losses should not be treated as losses from the sale of capital assets and, if it carries that burden successfully, to deduct those losses against the income from its business in which those losses were incurred.

SUMMARY OF ARGUMENT

This Court's decision in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), acknowledges and stands for the proposition that the literal language of the enumerated exclusions set out in the predecessor to Section 1221 of the Internal Revenue Code of 1954 does not include all non-capital assets. This Court decided that a narrow construction of the term "capital asset" and a broad interpretation of the enumerated

exclusions are needed to effect Congressional purpose. *Id.* at 52.

Two of the three judges who heard this case in the Court of Appeals decided, however, that the *Corn Products* decision must be confined to its facts and may not be read to permit the treatment of stock held by someone other than a securities dealer as anything other than a capital asset, regardless of the circumstances and purposes for which it was purchased and held. Their decision conflicts with decisions of this Court, with every other Circuit Court that has addressed the issue, with the United States Claims Court and the United States Tax Court, and is inconsistent with the prior opinions of the Eighth Circuit Court of Appeals itself.

The language of Section 1221 of the Code and its interpretation by Treasury regulations and Internal Revenue Service rulings permits judicial exclusion of transactions that should not receive capital treatment when that exclusion is necessary to effect Congressional purpose. Congress has considered and accepted *Corn Products* as applied by the courts generally, including its application to purchases of stock, and has considered and declined to adopt the position of the Eighth Circuit panel in this case.

Corn Products recognizes the practical considerations of doing business. It acknowledges that it is impossible to anticipate by statutory rule the almost infinite spectrum of ways in which taxpayers may need to respond to the operating needs of their businesses and allows the proper matching of tax consequences to the economic substance of transactions.

ARGUMENT

I. THE LANGUAGE OF SECTION 1221 AND OF ITS INTERPRETATIVE REGULATION PERMITS EXCLUSIONS BEYOND THOSE EXPRESSLY ENUMERATED.

The majority of the three-judge panel for the Court of Appeals decided that the shares of stock purchased by Arkansas Best had to be treated as capital assets because they were not specifically described by any of the statutory exclusions, as though Code Section 1221 defined "capital asset" to mean, "*all* property held by the taxpayer . . . *except,*" or "*all* property . . . *other than,*" or "*all* property . . . *except the following,*" *i.e.*, language not permitting the exclusion of any *item* of property, regardless of circumstances, unless described in a statutory exclusion.[1] But the statute does not say that, Treasury Regulations do not give the definition that construction, and the Internal Revenue Service does not follow that construction in its administration of the capital gain and loss provisions.

Section 1221 simply says that "capital asset means property held by the taxpayer . . . but does not include . . . ." It does not

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[1] *Arkansas Best Corp. & Subsidiaries v. Commissioner*, 800 F.2d 215, 218 (8th Cir. 1986). The Court of Appeals opinion (*Id.* at 218) quoted a statement in the Ways and Means Committee Report, H.R. REP. No. 704, 73rd Cong., 2d Sess. 31 (1934), for the Revenue Bill of 1934, stating, "It will be noted that the definition [of "capital assets"] includes all property, except as specifically excluded." The remark was not a contemporaneous construction (the statutory language, "capital asset means property held by the taxpayer . . . but does not include . . .," originated 13 years earlier in the Revenue Act of 1921, ch. 136, 42 Stat. 227, at 233 (1921)) and the remark was not made in the context of changing the definition. The only definitional change made by the House was to remove the holding period from the definition.

say, "all property," and the language it has always used to preface the statutory exclusions, "but does not include,"[2] does not rule out the possibility that "capital asset" also "does not include" some item of property not falling within the descriptions of the classes excluded by the statute if that exclusion is necessary to effect Congressional purpose.[3]

The Treasury Regulation's interpretation[4] is consistent with this construction. It says, "The term, 'capital assets,' *includes* all *classes* of property not specifically excluded by section 1221" (emphasis added), meaning simply that there are no other excluded *categories or classes.* That is not the same as saying, and the Regulation does not say, that every item of property outside the description of each excluded class is a capital asset. A share of stock in Acme Corporation can represent among other possibilities a long-term portfolio investment for an investor, inventory for a securities dealer, the right to a ratable share of Acme's production for Acme's distributor, an opportunity for a short-swing profit on the stock market for a securities trader, and future compensation income upon its sale for Acme's employee. The Internal Revenue Service has construed the definition of Section 1221 in that manner in administering the capital gain and loss provisions.[5]

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[2] The phrase originated in Section 206(a)(6) of the Revenue Act of 1921, ch. 136, 42 Stat. 227, 233 (1921).

[3] *See* Code Section 7701(c) defining "includes" and "including."

[4] Treas. Reg. § 1.1221-1(a) (1957).

[5] *See, e.g.,* Rev. Rul. 58-40, 1958-1 C.B. 275; Rev. Rul. 72-238, 1972-1 C.B. 65; Rev. Rul. 78-396, 1978-2 C.B. 114.

II. CONGRESS CONSIDERED AND DECLINED TO ADOPT THE POSITION TAKEN BY THE EIGHTH CIRCUIT IN THIS CASE AND, INSTEAD, ACCEPTED THE APPLICATION OF *CORN PRODUCTS* TO STOCK.

The House Committee on Ways and Means for the 94th Congress was asked to amend the Code by adopting a flat rule that all securities acquired for business reasons (except securities acquired by dealers and except for certain bonds acquired by banks) be considered capital assets. Dispositions of all such securities would then receive capital gain or loss treatment regardless of the circumstances surrounding their acquisition and sale. Both houses of Congress declined to adopt such a rule and, instead, passed legislation which accepted the application of *Corn Products* to provide ordinary gain or loss treatment for sales of securities in appropriate circumstances.

The history of this Congressional action began in 1975 when a member of the Committee on Ways and Means introduced H.R. 10902 in the first session of the 94th Congress, proposing the addition of a new Section 1254 to Subchapter P of the Internal Revenue Code of 1954.[6] The committee reports on the bill described current law and the reason for H.R. 10902 as follows:

> The question of whether a security (or any asset) is a capital asset is factual and depends on the facts and circumstances of the particular case, i.e., whether the taxpayer acquired and held the security as an investment or whether he acquired and held it for sale to customers in

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[6] 121 CONG. REC. 37,907 (1975). The text of H.R. 10902 as introduced may be found in *Miscellaneous Minor Tax Bills, 1975: Hearings Before the House Committee on Ways and Means*, 94th Cong., 1st Sess., at 202-203 (1975).

> the ordinary course of business or held the stock for use in his business.
>
> . . . .
>
> Purchases of stock to protect the taxpayer's source of income or his source of supply of another company's products have been held to be situations of this general kind where taxpayers have often been upheld in treating their loss as ordinary rather than capital. Few, if any, situations have arisen, however, where in similar circumstances a gain on later sale of the stock or securities has been held to be ordinary income. [Footnote omitted.]
>
> Your committee has concluded that, under present law, a taxpayer can too readily obtain the best of both worlds when he sells or exchanges a stock or other security and knows whether he has a gain or a loss, by contending that he did not hold the stock as an investment (if he wants ordinary loss treatment) or that he did hold it as an investment (if he wants capital gain treatment).

H.R. REP. No. 1360, 94th Cong., 2d Sess. 3 (1976); S. REP. No. 1392, 94th Cong., 2d Sess. 2-3 (1976). Each of the three cases cited by the reports as examples of current law applied the approach of *Corn Products* to determine whether a loss on the sale or worthlessness of stock that had been purchased by a business or for a business purpose should be treated as an ordinary or capital loss.[7]

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[7] *Union Pacific R.R. Co. v. United States*, 524 F.2d 1343 (Ct. Cl. 1975), *cert. denied*, 429 U.S. 827 (1976) (on the facts, upholding ordinary loss treatment); *W. W. Windle Co. v. Commissioner*, 65 T.C. 694 (1976), *appeal dismissed*, 550 F.2d 43 (1st Cir.), *cert. denied*, 431 U.S. 966 (1977) (on the facts, denying ordinary loss treatment); *Corsello v. Commissioner*, 35 T.C.M. (CCH) 832 (1976) (on the facts, upholding ordinary loss treatment).

H.R. 10902 addressed this by requiring, as a condition precedent to claiming an ordinary loss, that the taxpayer notify the Internal Revenue Service within 30 days after acquiring the security that he did not acquire it as an investment.[8]

The Department of the Treasury opposed H.R. 10902 and suggested an alternative solution, almost identical to the rule adopted by the Eighth Circuit panel's majority opinion in this case: "Treasury suggests that the Committee consider whether ordinary income and loss treatment on the sale of securities should be eliminated in all cases." STAFF OF THE JOINT COMM. ON INT. REV. TAX., 94th CONG., 1st SESS., DESCRIPTION OF TECHNICAL AND MINOR BILLS LISTED FOR A HEARING, (Comm. Print 1975).[9]

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[8] H.R. 10902 provided that if a business taxpayer (other than a securities dealer) realized a loss on sale of the security, he would be permitted to contend for ordinary loss treatment only if he had filed the notice of no investment purpose within 30 days after his purchase, and if he had not filed the notice, he would receive capital loss treatment, regardless of the circumstances. If, however, the taxpayer had filed the notice of no investment purpose, a gain on the later sale of the security would not be given capital gain treatment, regardless of circumstances. The bill left the Commissioner free to impose ordinary gain treatment under *Corn Products* even though the business taxpayer did not file the notice.

[9] At a public hearing on the bill before the Ways and Means Committee, one of the witnesses also urged the Treasury Department's alternative of a flat prohibition:

> I would suggest to the committee when they mark up this bill that they consider a flat rule that all securities acquired by businesses should be considered capital assets and therefore receive capital gains treatment, except for dealers in securities, who would obviously be accorded ordinary income treatment. Also the bank bonds under section 852, which is mentioned in the pamphlet should be exempted.

The Committee on Ways and Means did not adopt the proposed alternative. Instead, it approved H.R. 10902, accepting the possibility of ordinary loss treatment for securities acquired for business purposes and reported the bill to the full House[10] which passed it as reported on August 24, 1976.[11] The Senate Finance Committee also did not adopt the Treasury's suggestion, although it amended the bill to prohibit the taxpayer from avoiding his notice of no investment purpose by a transfer to a related party that would not file the notice.[12] The bill, as amended, was reported to and passed by the Senate on October 1, 1976.[13] The House and Senate adjourned on that day,[14] and H.R. 10902 did not go to a conference of the two houses.

Since 1976, five Congresses have had the opportunity to return to the subject and reconsider the proposed ban on ordinary gain or loss treatment for sales of stock which both the House Committee on Ways and Means and the Senate

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Miscellaneous Minor Tax Bills, 1975: Hearings Before the House Committee on Ways and Means, 94th Cong., 1st Sess. 149-150 (1975) (Statement of Robert Brandon, Director, Public Citizens' Tax Reform Research Group).

[10] 122 CONG. REC. 23,549 (1976). On the floor, the Chairman of the Committee on Ways and Means (Mr. Ullman) and a minority member (Mr. Steiger) urged passage, explaining the bill as in the committee reports. 122 CONG. REC. 27,459-60 (1976). The text of Section 1254 in H.R. 10902 as reported and passed by the House may be found in H. REP. NO. 1360, 94th CONG., 2d SESS., at 6-7 (1976).

[11] 122 CONG. REC. 27,499 (1976).

[12] For a description of the Senate Finance Committee amendment, *see* S. REP. NO. 1392, 94th CONG. 2d SESS. 4-5 (1976).

[13] 122 Cong. Rec. 34,589, 34,664 (1976).

[14] 122 Cong. Rec. 35,078, 35,377 (1976).

Committee on Finance declined to adopt in 1976. Although Congress has considered and enacted tax legislation in each of the years 1977 through 1986,[15] it has not passed any provision to place gain or loss from disposition of stock beyond the reach of *Corn Products* or even to place some limitation on the application of that decision.[16]

III. THE EIGHTH CIRCUIT PANEL'S INTERPRETATION OF *CORN PRODUCTS* IN THIS CASE IS INCONSISTENT WITH THE VIEWS OF THAT CIRCUIT EXPRESSED IN ITS PRIOR DECISIONS.

The majority on the Eighth Circuit's three-judge panel in this case said,

> We do not read *Corn Products* as either requiring or permitting the courts to decide that capital stock can be anything other than a capital asset under Section 1221.

800 F.2d at 221. This narrow reading of *Corn Products* is not reflected in any prior opinion of the Eighth Circuit. In contrast, that Court had, prior to its decision in this case, avoided

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[15] *See, e.g.*, Tax Reduction and Simplication Act of 1977, PUB. L. NO. 95-30, 91 Stat. 126 (1977); Revenue Act of 1978, PUB. L. NO. 95-600, 92 Stat. 2763 (1978); PUB. L. NO. 96-167, 93 Stat. 1275 (1979); PUB. L. NO. 96-601, 94 Stat. 3495 (1980); Economic Recovery Tax Act of 1981, PUB. L. NO. 97-34, 95 Stat. 172 (1981); Tax Equity and Fiscal Responsibility Act of 1982, PUB. L. NO. 97-248, 96 Stat. 324 (1982); Interest and Dividend Tax Compliance Act of 1983, PUB. L. NO. 98-67, 97 Stat. 369 (1983); Defieit Reduction Act of 1984, PUB. L. NO. 98-369, 98 Stat. 494 (1984); PUB. L. NO.99-121, 99 Stat. 505 (1985); Tax Reform Act of 1986, PUB. L. NO. 99-514, 100 Stat. 2085 (1986).

[16] *Cf. Corn Products Ref. Co.*, 350 U.S. 46, 52-53 (1955) (in view of a well-recognized 20-year-old interpretation, Congress' failure to change it while re-enacting the Code on several occasions "bespeaks congressional approval.").

such a dogmatic, inflexible approach. The Eighth Circuit's opinions on the process of determining whether some item of property is within or without the Code's "capital asset" definition are as follows.[17] In *Greenspon v. Commissioner*, 229 F.2d 947, 951 (8th Cir. 1956):

> In general, the courts take the position that each case must be determined upon its particular facts, and that *no definite formula for deciding cases of this type can be prescribed.* [Emphasis added.]

In *Frank v. Commissioner*, 321 F.2d 143, 148 (8th Cir. 1963):

> It has been said that no fixed formula exists for resolving the issue; that no one factor is necessarily decisive, and that "a congeries of factors is to be considered and weighed." *Tidwell v. Commissioner*, 298 F.2d 864, 866 (4 Cir. 1962); *Lockhart v. Commissioner*, 258 F.2d 343, 347 (3 Cir. 1958).

And from the same opinion, *id.* at 148-149:

> We also have in mind that the phrase "capital asset" in § 1221 is to be narrowly applied; that its exclusions are to be interpreted broadly; and that every day operations of a business are directed to ordinary income or loss rather than to capital gain or loss. *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 52 (1955); *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260, 265 (1958); *Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130, 134 (1960).

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[17] The majority opinion of the Eighth Circuit's three-judge panel in this case ignores these views. It cites to *Frank v. Commissioner*, 321 F.2d 143 (8th Cir. 1963), but only for the holding that since the taxpayers in that case were in the business of selling securities, they were not entitled to capital gain treatment for their stock sale profits. 800 F.2d at 219.

In *Vaaler v. United States,* 454 F.2d 1120, 1122 (8th Cir. 1972):

> Over the years considerable case law has evolved to further illuminate the meaning of the term "capital asset." In *Commissioner v. Gillette Motor Transport,* 364 U.S. 130, at 133, 80 S.Ct. 1497, at 1500 4 L.Ed.2d 1617, at 1621, Mr. Justice Harlan writing for the Court said, "While a capital asset is defined in § 117(a)(1) as 'property held by the taxpayer,' it is evident that not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset .... Thus the Court has held that an unexpired lease, *Hort v. Commissioner,* 313 U.S. 28, 61 S. Ct. 757, 85 L.Ed. 1168, corn futures, *Corn Products Ref. Co. V. Commissioner,* 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed 29, and oil payment rights, *Commissioner v. P.G. Lake, Inc.,* 356 U.S. 360, 78 S.Ct. 691, 2 L.Ed.2d 743, are not capital assets even though they are concededly 'property' interests in the ordinary sense."

And from the same opinion, *id.,* at 1122, quoting approvingly from *Commissioner v. Ferrer,* 304 F.2d 125, 129 (2d Cir. 1962):

> Section 117(a) of the 1939 Code, now § 1221 of the 1954 Code, 26 U.S.C.A. § 1221, tells us, not very illuminatingly, that "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include four (now five) types of property therein defined. *However it has long been settled that a taxpayer does not bring himself within the capital gains provision merely by fulfilling the simple syllogism that a contract normally constitutes "property," that he held a contract and that his contract does not fall within a specified exclusion. C. I. R. v. Gillette Motor Transport, Inc.,* 364 U.S. 130, 134-135, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960); Surrey, Definitional Problems in Capital Gains Taxation, 69 Harv. L. Rev. 985, 988 (1956). This is easy enough; *what is difficult,*

perhaps impossible, is to frame a positive definition of universal validity. [Emphasis added.]

IV. *CORN PRODUCTS* ALLOWS FOR THE PROPER MATCHING OF TAX CONSEQUENCES TO THE UNDERLYING ECONOMIC SUBSTANCE OF BUSINESS MOTIVATED TRANSACTIONS.

This Court, in *Corn Products* and in other cases which preceded and followed it, has consistently held that the Code definition of capital asset must be interpreted narrowly and the exclusions from that definition broadly,[18] in order to properly categorize capital and non-capital assets. These cases recognize the practical impossibility of drafting a statute that would

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[18] *Corn Products Ref. Co. v. Commissioner,* 350 U.S. 46, 52 (1955). *Cf. United States v. Midland-Ross Corp.,* 381 U.S. 54 (1965); *Commissioner v. Brown,* 380 U.S. 563 (1965); *Commissioner v. Gillette Motor Transport, Inc.,* 364 U.S. 130 (1960); *Commissioner v. P. G. Lake, Inc.,* 356 U.S. 260 (1958); *Kieselbach v. Commissioner,* 317 U.S. 399 (1943); *Hort v. Commissioner,* 313 U.S. 28 (1941); *Burnet v. Harmel,* 287 U.S. 103 (1932).

Respondent in its Brief on Petition for a Writ of Certiorari (pp. 11 and 12) misperceives that a statement of this Court in *Malat v. Riddell,* 383 U.S. 569, 572 (1966), supports Respondent's belief "that this Court's holding in *Corn Products* . . . was that the corn futures in the circumstances of that case fell within the 'inventory' exception to what is now Section 1221." As support for that reading of *Corn Products,* the Respondent refers to a statement in this Court's opinion in *Malat* which Respondent quotes as follows: "[a] literal reading of [Section 1221] is consistent with [its] legislative purpose." The Respondent, however, substituted "Section 1221" for this Court's reference to "the statute." The substitution significantly distorts the meaning of this Court's statement. "[T]he statute" to which this Court was referring was paragraph (1) of § 1221, and the question was whether a literal reading of the word "primarily," in paragraph (1) to mean, "of first importance," was consistent with the legislative purpose of Section 1221.

precisely divide all assets into capital and non-capital categories in all the contexts and circumstances which may arise.[19]

Rather than elevate form over substance,[20] as does the majority opinion of the Eighth Circuit panel in this case, this Court has considered the purpose for which an asset was acquired and held, together with its nominal nature. This approach allows tax consequences to turn on the underlying economic substance of a transaction, taking into account the context and relevant circumstances surrounding the purchase, retention, and disposition of an asset by the taxpayer, rather than solely on the nominal nature of the asset involved.

Similarly, prior cases and courts which have interpreted and followed *Corn Products* have recognized that the nominal form of the asset is not determinative. Thus, courts have determined that in the context of a particular factual situation, stock purchased and held to acquire markets, marketing technique and know-how,[21] baseball players' contracts which although not primarily held for sale were the essence of the taxpayer's

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[19] This impossibility was acknowledged in *Commissioner v. Gillette Motor Transport, Inc.*, 364 U.S. 130 (1960), as follows: "While a capital asset is defined in [the predecessor to § 1221] as 'property held by the taxpayer,' it is evident that not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset." *Id.* at 134.

[20] This Court has long held that it is the substance and not the form of a transaction which is determinative of federal income tax consequences. *See, e.g., Commissioner v. Court Holding Company*, 324 U.S. 331, 334 (1945), *Gregory v. Helvering*, 293 U.S. 465, 470 (1935).

[21] *Schlumberger Technology Corp. v. United States*, 443 F.2d 1115 (5th Cir. 1971).

business,[22] bonds deposited as security for the performance of a contract,[23] stock purchased to prevent a lawyer from being terminated as that corporation's legal counsel,[24] stock purchased to insure a supply of dresses for a department store,[25] and stock acquired to insure a source of supply of petroleum products for a wholesaler of petroleum products,[26] were not capital assets. Congress could not draft a capital asset definition which would give the correct classification simply by looking up any of the foregoing, or any as yet unanticipated items, in a statutory list of exclusions and inclusions. The courts, however can, and do, make the statute work.

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[22] *Hollywood Baseball Ass'n v. Commissioner*, 423 F.2d 494 (9th Cir. 1970), *cert. denied*, 400 U.S. 848 (1970).

[23] *Commissioner v. Bagley & Sewall Co.*, 221 F.2d 944 (2nd Cir. 1955).

[24] *Steadman v. Commissioner*, 424 F.2d 1 (6th Cir. 1970), *cert. denied*, 400 U.S. 869 (1970).

[25] *Smith & Welton, Inc. v. United States*, 164 F. Supp. 605 (D. Va. 1958).

[26] *FS Services, Inc. v. United States*, 413 F.2d 548 (Ct. Cl. 1969).

CONCLUSION

Thirty-two years have passed since this Court's decision in *Corn Products*. Over that period the lower courts have developed a substantial and flexible body of case law in reliance on it which has adapted tax consequences to the substance of business transactions. Congress has recognized and accepted that body of case law, effectively reaffirming it as an appropriate interpretation of the statute and Congressional purpose. If and when Congress chooses to change that law it may easily do so prospectively. The decision of the Eighth Circuit panel below attempts to overrule this Court's opinions on the subject and the case law based upon them. It should be reversed.

Respectfully submitted,

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